GSA

DEC 13 2005

GSA Office of the Chief Acquisition Officer

MEMORANDUM FOR DAVID CAPITANO
DIRECTOR
DEFENSE ACQUISITION REGULATIONS COUNCIL

FROM: RALPH J. DESTEFANO, DIRECTOR
REGULATORY AND FEDERAL ASSISTANCE
PUBLICATIONS DIVISION

SUBJECT: FAR Case 2003-027, Additional contract Types

Attached are comments received on the subject FAR case published at 70 FR 71448; November 29, 2005. The comment closing date is December 9, 2005.

Response Number	Date Received	Comment Date	Commenter
2003-027-1	11/16/05	11/16/05	ABA
2003-027-2	11/16/05	11/16/05	DOT
2003-027-3	11/23/05	11/23/05	ESRI
2003-027-4	11/23/05	11/23/05	Alma Edgerly
2003-027-5	11/25/05	11/25/05	Distributed Solutions, Inc.
2003-027-6	11/30/05	11/30/05	Colleen Loiselle
2003-027-7	12/08/05	12/08/05	DCAA
2003-027-8	12/09/05	12/09/05	CODSIA
2003-027-9	12/09/05	12/08/05	ITAA
2003-027-10	12/09/05	12/09/05	POGO

U.S. General Services Administration
1800 F Street, NW
Washington, DC 20405-0002
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Response Number	Date Received	Comment Date	Commenter
2003-027-11	12/09/05	12/09/05	CSA
2003-027-12	12/09/05	11/21/05	Coalition for Government Procurement
2003-027-13	12/12/05	12/12/05	GSA/OIG

Attachments

2003-027-1

Defending Liberty
Pursuing Justice

AMERICAN BAR ASSOCIATION

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November 16, 2005

VIA ELECTRONIC MAIL AND FIRST CLASS MAIL

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Room 4035
Washington, D.C. 20405
Attn: Ms. Laurieann Duarte

Re: Proposed Rule, FAR Case 2003-027, 70 Fed. Reg. 56318 (Sept. 26, 2005); Additional Contract Types

Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.[1]

[1] This letter is available in pdf format at http://www.abanet.org/contract/Federal/regscomm/home.html under the topic "Commercial Items."

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The September 26, 2005 proposed rule would amend the Federal Acquisition Regulation ("FAR") to implement section 1432 of Title XIV of the National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136. Title XIV of the Act is known as the Services Acquisition Reform Act ("SARA"). Section 1432 amended section 8002(d) of the Federal Acquisition Streamlining Act ("FASA") (Pub. L. No. 103-355, Oct. 13, 1994, *codified* at 41 U.S.C. § 264 note) to expressly authorize the use of time-and-materials ("T&M") and labor-hour ("LH") contracts for commercial services acquisitions.

As amended, section 8002(d) imposes certain requirements on Federal agencies that intend to use T&M or LH contracts to procure commercial services under the commercial item procedures of Part 12 of the Federal Acquisition Regulation ("FAR"). 48 C.F.R. Part 12. Specifically, (1) the contract or order must be issued on a competitive basis; (2) the service must be a commercial service as defined in certain categories prescribed in section 8002(d); (3) the contracting officer must prepare a determination and findings ("D&F") that no other contract type is suitable; and (4) the contracting officer must include a ceiling price that the contractor would exceed at its own risk and that can only be increased when the contracting officer determines that such an increase is in the agency's best interests.

On September 20, 2004, the Councils issued an Advance Notice of Proposed Rulemaking ("ANPR") to solicit information from the public about how T&M and LH contracts are used commercially. 69 Fed. Reg. 56316 (Sept. 20, 2004). The ANPR also included a preliminary draft of revisions to the FAR's current commercial items policies and associated contract clauses, which were originally intended only to support acquisitions through firm fixed-price or fixed price with economic price adjustment contracts.

The Section provided comments on the ANPR on November 18, 2004. We attach a copy of those comments for your convenience. In the proposed rule the Councils provided an extensive response to most, if not all, of the Section's comments. Rather than repeat our previous comments that the Councils already have considered, these comments are confined to areas where the proposed rule differs from the ANPR, and to issues we think deserve special emphasis or require further discussion.

1. Indirect Costs

The Section believes the proposed rule contains an ambiguity regarding how indirect costs are to be reimbursed. The proposed rule explains that indirect costs, such as a material handling fee, may be reimbursed according to a fixed

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amount applied on a pro-rata basis over the contract performance period.[2] *See* proposed Alternate I to FAR 52.212-4(i)(1)(ii)(E)(2). The proposed rule includes indirect costs in the definition of material costs. *Id.* at 52.212-4(e). But material costs, according to the proposed rule, are to be reimbursed according to their "actual cost" (unless those material costs are commercial items, in which case they will be paid according to the catalog or market price). *Id.* at 52.212-4(i)(1)(ii)(C). Thus, the proposed rule establishes two contradictory methods to pay for indirect costs. The Section suggests that this conflict could be resolved by simply removing indirect costs from the definition of material costs.

2. Employee Interviews

Both the ANPR and the proposed rule would give contracting officers the right, on commercial T&M and LH contracts, to interview the contractor's employees to verify whether the employees have worked the hours indicated on the invoices. Id. at 52.212-4(i)(4). This new right would seemingly apply to the employees of prime contractors and subcontractors alike. Although the Section raised concerns about this issue in its ANPR comments, we think those concerns bear repeating. The Section believes a Government right to compel such interviews is an unprecedented expansion of the Government's contractual audit rights. No such right exists for any other contract types. Indeed, no such right even exists for noncommercial T&M contracts, which typically include greater Government oversight rights than the commercial counterparts.

The proposed rule asserts that this right to compel employee interviews is no broader than what is already provided in FAR clause 52.215-2, Audit and Records – Negotiation. We do not believe that is correct. That clause gives the contracting officer the right to examine "records and other evidence" to verify costs claimed by the contractor. "Records" is not defined to include interviews, and it strains credulity to believe that "other evidence" means employee interviews. Therefore, we believe a Government contractual right to compel employee interviews to verify that they worked the hours they claim to have worked lacks precedent in the FAR.

Moreover, we continue to believe that a newly created contractual right to compel employee interviews is largely unnecessary to protect the Government's interests. As we pointed out in the ANPR comments, the Government already has the ability to interview employees in cases of alleged fraud or wrongdoing pursuant to its subpoena powers under applicable statutes. Further, contractors already have

[2] The Councils explained that a fixed rate would violate the prohibition on cost plus percentage of cost contracts. *See* proposed rule at 56325.

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sufficient incentive to make sure invoices are accurate lest they risk civil and criminal liability for false claims and false statements.

The proposed rule, nevertheless, contends that the Government should not have to rely on the contractor's invoice, apparently even when there are no indicia of fraud or wrongdoing. This reasoning, however, has no logical end. If the contractor's invoice is not sufficient proof, why should the employee's interview be enough? The question, therefore, is what level of proof is sufficient. We believe that line is properly drawn at the invoices – which are required, under penalty of law, to be accurate. We also do not believe the right to interview employees is consistent with commercial practices. Because neither SARA nor any other law requires that contracting officers have a right to interview employees, we recommend removing it.

3. Payments for Subcontract Labor

Under the proposed rule, if the subcontractor is identified in the proposed Alternate I to FAR clause 52.212-4, the Government will pay the prime contractor for subcontract labor at the hourly rates prescribed in the contract schedule. This approach is largely consistent with our recommendation in the ANPR comments. We do, however, request a clarification. We interpret the proposed rule to allow the parties to identify as few or as many subcontractors as they deem appropriate, and the prime contractor is not *required* to use any of them. In other words, the parties would be establishing a pool of potential subcontractors whose rates would be paid at the schedule rates. We believe this is permitted by the proposed rule and that the consent to subcontract requirements still protect the Government's interests. In order to make the proposed rule more clear on this point, we suggest the parenthetical instructions in proposed Alternate I to FAR 52.212-4(i)(1)(ii)(B)(2) be revised (indicated in bold) as follows:

> *Insert **actual or potential** subcontractor name(s) or, if no subcontractors are to be reimbursed at the hourly rates prescribed in the schedule, "None." If this is an indefinite delivery contract, the Contracting Officer may insert "Each order must list separately the **actual or potential** subcontractor(s) for that order or, if no subcontracts under that order are to be reimbursed at the hourly rates prescribed in the schedule, insert 'None.'"*

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The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Robert L. Schaefer
Chair

cc: Michael A. Hordell
Patricia A. Meagher
Michael W. Mutek
Carol N. Park-Conroy
Patricia H. Wittie
Hubert J. Bell, Jr.
Mary Ellen Coster Williams
Council Members
Co-Chairs and Vice-Chairs of the Commercial Products and Services Committee
David Kasanow

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AMERICAN BAR ASSOCIATION

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November 18, 2004

VIA FACSIMILE AND FIRST CLASS MAIL

General Services Administration
Regulatory Secretariat (VR)
Attn: Ms. Laurie Duarte
1800 F Street, N.W.
Room 4035
Washington, D.C. 20405

Re: FAR Case 2003-027, Advance Notice of Proposed Rulemaking, Additional Commercial Contract Types 69 Fed. Reg. 56316 (September 20, 2004)

Dear Ms. Duarte:

On behalf of the Section of Public Contract Law of the American Bar Association ("the Section"), I am submitting comments on the above-referenced matter. The Section consists of attorneys and associated professionals in private practice, industry, and Government service. The Section's governing Council and substantive committees contain members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the Association's Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, therefore, should not be construed as representing the policy of the American Bar Association.

Introduction

The Advance Notice of Proposed Rulemaking ("ANPR"), published in the Federal Register on September 20, 2004, solicits comments to help the FAR Councils implement part of the Services Acquisition Reform Act ("SARA"), which was enacted in Title IV of the National Defense Authorization Act for Fiscal Year 2004, Pub. L. No. 108-136. Section 1432 of SARA amended section 8002(d) of the Federal Acquisition Streamlining Act ("FASA") (Pub. L. No. 103-355, Oct. 13, 1994, *codified* at 41 U.S.C. § 264 note) to expressly authorize the use of time-and-materials ("T&M") and labor-hour ("LH") contracts for commercial services acquisitions.

As amended, section 8002(d) imposes certain requirements to use T&M or LH contracts to procure commercial services under the commercial item procedures of Part 12 of the Federal Acquisition Regulation ("FAR"). FAR Part 12; 48 C.F.R. Part 12. Specifically, (1) the contract or order must be issued on a competitive basis; (2) the service must be a commercial service as defined in certain categories prescribed in section 8002(d), including any categories of services determined to be commercial by the Administrator of the Office of Federal Procurement Policy ("OFPP"); (3) the contracting officer must prepare a determination and findings ("D&F") that no other contract type is suitable; and (4) the contracting officer must include a ceiling price that the contractor would exceed at its own risk and that can only be increased when the contracting officer determines that it is in the best interests of the agency.

The Councils have provided in the ANPR a preliminary draft of revisions to the FAR's current commercial items policies and associated contract clauses, which were originally intended only to support acquisitions through firm fixed-price or fixed-price with economic price adjustment contracts. The ANPR requests public comments on how best to implement these revisions to ensure that they address the risks associated with T&M and LH contracting.

As we did in our comments on July 25, 2001, on the Proposed Rule for Contract Types for Commercial Items (FAR Case 2000-013), the Section supports the implementation of T&M and LH contracts for commercial services and generally applauds the Councils' efforts in this regard in this ANPR. We have, however, several comments and suggestions, as well as responses to some of the specific questions posed in the ANPR, each of which is addressed below.

While our comments are primarily concerned with implementing new rules and contract clauses for T&M and LH commercial services in a way that is consistent with commercial buying practices, we do not presume to identify all the

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standard commercial services buying practices across all industries. Nor do we offer an opinion regarding which industries or which types of services OFPP should conclude are commercial. Instead, for purposes of these comments, we have in mind those services that have traditionally fallen within the definition of a commercial item in FAR 2.201. Recognizing that the definition of a commercial service will be evolving (pursuant to OFPP's identification of other categories of commercial services), our commentary is aimed at giving the contracting officer sufficient discretion to implement contract terms and conditions that are appropriate for the particular commercial services that are being purchased. Rather than implementing a one-size-fits-all approach to commercial buying practices, we believe that our approach best suits the policy of enabling the Government to purchase commercial services under more commercial-like terms and conditions.

Discussion

1. Application of the Final Rule to Existing Contracts and Orders

As an initial matter, we note that the Councils' preliminary draft does not address how or whether the new regulations and contract clauses for procuring T&M and LH commercial services would apply to contracts and task orders that are in effect before implementation of the final rules. We believe application of any final rules and regulations to outstanding contracts and orders would be administratively burdensome to both contractors and the Government, and would add unnecessary confusion and uncertainty to the ongoing projects. Accordingly, we recommend that the final rules explicitly state that they apply to contracts and orders that are executed on or after the effective date of those rules.

Where a task order contract is involved, however, we recommend that the Councils consider allowing contractors to request contracting officers to modify existing contracts to allow for T&M and LH task orders, so that implementation is not delayed. Thus, a task order awarded after the effective date of the rule could be on a T&M or LH basis even though the underlying contract was awarded prior to the effective date, if the underlying contract was so modified. Such modifications should be by mutual agreement without consideration. If a limitation on such authority is deemed necessary, such an avenue could be limited, for example, to contracts awarded subsequent to passage of SARA.

2. Draft Revisions of Contract Clauses

As part of the implementation of T&M and LH contracts for commercial services, the Councils have drafted preliminary revisions to the standard FAR Part 12 clauses that are used in commercial item acquisitions. The current FAR Part 12

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clauses are intended to be used only for fixed price contracts. *See* FAR 12.207; 48 C.F.R. § 12.207. The draft revisions, which are based largely on the standard clauses for non-commercial services that are acquired on a T&M or LH basis, would be in the form of an alternative clause that modifies FAR 52.212-4 by replacing the provisions for fixed-price work with the alternative provisions for T&M or LH work.

Although we generally agree with that approach, we nevertheless have a few comments and suggestions to make the new rules and contract provisions more consistent with commercial buying practices. FASA mandates that government agencies rely to the maximum extent practicable on commercial products and services to fill the Government's needs. FASA §§ 8002, 8104. FASA also requires that an agency impose only those terms and conditions in commercial item contracts that are required by law or that are customary in the commercial market place. *Id.*; *see also* FAR 12.302; 48 C.F.R. § 12.302.

a. Implementation of T&M and LH Contract Clauses

The Councils' draft contemplates that the changes to FAR 52.212-4 to implement T&M and LH contracts would be in an alternative clause that the contracting officer would include in the contract if T&M or LH work were being performed. The implication in using an alternative clause is that it would replace certain provisions in FAR 52.212-4 that apply to fixed-price contracts. This suggests that a contract would not include *both* the provisions necessary for fixed-price services *and* T&M and LH services. If this is indeed the case, the contracting officer would be unable to issue fixed-price task orders under the same contract that contemplates T&M or LH task orders, and vice versa. We believe it would be in the best interests of contractors and the Government if the parties had the flexibility to perform fixed-price or T&M and LH orders as appropriate under the same contract. Accordingly, we suggest that implementing guidance make clear that standard and alternate clauses can be used in the same contract. Alternatively, rather than prescribing an alternative clause, the FAR Councils could prescribe a separate clause for use with T&M and LH contracts and orders so that the clause can be used with the standard provisions for fixed price work in contracts where work may be performed pursuant to fixed price and T&M or LH orders.

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b. Ceiling Price

The payment provision in the ANPR's draft alternative clause to FAR 52.212-4 requires the contracting officer to establish a ceiling price, within which the contractor must use "best efforts" to complete the work. It is not clear, however, how the ceiling price is to be established or what it should be based upon. This may cause a practical problem if the ceiling price is intended to be based on the estimated total cost of the T&M or LH work rather than simply being based on the availability of appropriated funds.

One of the primary reasons for T&M and LH work is that an accurate estimate of the total cost cannot be reasonably pre-determined with any degree of confidence. *See* FAR 16.601(b); 48 C.F.R. § 16.601(b). Indeed, if an accurate calculation of the total cost were possible, it would eliminate one of only two justifications available under the draft rules for issuing a T&M or LH contract instead of a fixed price contract. Under the ANPR's draft rules, which closely mirror the current rules for non-commercial T&M and LH services, the contracting officer must first execute a D&F stating that either (1) it is impossible to accurately estimate the extent or duration of the work, or to anticipate costs with any degree of certainty; or (2) fixed pricing would unduly inflate the Government's costs or impose unreasonable risk on the contractor. If contracting officers were required to establish the ceiling price according to the anticipated costs, the first justification may be effectively nullified: How could a contracting officer on one hand state in the D&F that the total cost cannot be estimated with confidence, while on the other hand base a ceiling price on the estimated cost? The Section, therefore, suggests revising the draft payment clause so that the ceiling price is simply based on the availability of appropriated funds rather than the cost of performance. This solution has the benefits of being straightforward and preserving the availability of the first justification for issuing a T&M or LH contract; *i.e.*, that an accurate estimate of the cost of the work is impossible to ascertain with a reasonable degree of confidence.

c. Inspection/Acceptance

The draft inspection and acceptance provision in the ANPR makes a significant change from the standard inspection and acceptance provision used for non-commercial T&M and LH services. *See* FAR 52.246-6(f); 48 C.F.R. § 52.246-6(f). Specifically, the new provision requires contractors to repair or replace rejected supplies or reperform rejected services at no cost to the Government. This change may make the new inspection/acceptance provision *less* consistent with standard commercial practices and imposes *more* contract risk on the contractor than under the non-commercial clause, which does *not* require repair or

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reperformance at no cost to the Government. *Id.* Rather, FAR 52.246-6 specifically provides for the payment of costs (but not profit) incurred to perform corrective work.

Under the ANPR's draft clauses, contractors will likely view the possibility of having to reperform services or repair supplies at no cost as requiring them to bear a level of risk that is similar to that of fixed-price work. This is especially so where, as here, the draft clauses combine (1) a ceiling price that contractors exceed at their own risk (rather than an estimate, which as explained below is more common in some commercial industries), and (2) a requirement that the contractor use "best efforts" to perform within the ceiling price (which may be a different standard of performance than contractors routinely provide under commercial warranties). Under the draft clauses, contractors may interpret a commercial T&M or LH contract to require accomplishment of a certain result, *i.e.*, "performance of the work specified in the Schedule," within a specified dollar amount, *i.e.*, the ceiling price. Having to reperform any work that does not accomplish the required result (*i.e.*, deficient) without additional compensation may well be viewed by commercial contractors as an unacceptable allocation of the parties' respective contract risks for T&M or LH work. Several adverse consequences could result:

- contractors will propose higher profit margins to cover the additional risk;
- contractors, during negotiations, may insist that the Government set artificially high ceiling amounts; and/or
- contractors, during contract performance, will have little incentive to complete the work under the ceiling amount because they will choose instead to perform quality assurance and testing beyond standard commercial practice in order to mitigate the risk of suffering losses resulting from having to reperform rejected work for free.

None of these scenarios is favorable to the Government's interests. To avoid these possibilities – and to ensure that T&M and LH work is an effective alternative to fixed-price work for commercial services – we suggest allowing the contracting officer, where appropriate, to provide that the contractor will be compensated for reperformance or repair of deficient services or supplies, respectively, up to the ceiling amount, but not including profit. This would be consistent with the non-commercial T&M and LH clauses and would give the Government the ability to more accurately reflect standard commercial practices.

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Additionally, the term "best efforts" is normally associated with a standard of effort to meet required performance rather than a standard for cost containment. In this regard, if a standard of effort to achieve cost containment is deemed necessary, "reasonable efforts" or "all reasonable efforts" would be a better choice.

3. **Dollar Threshold for Filing a D&F**

Consistent with the requirements of SARA, the ANPR requires that the contracting officer execute a D&F stating that no other contract type is suitable before making a purchase on a T&M or LH basis. Neither SARA nor the ANPR establishes a dollar threshold for this requirement. Accordingly, a D&F would be required for every T&M or LH transaction *no matter how small*. This may unduly hamper the Government's ability to procure commercial services efficiently. Contracting officers may find it necessary or more efficient to quickly issue small task orders for T&M or LH work. For example, it may be necessary due to time constraints for a contractor to begin work immediately rather than waiting until a more definitive, fixed-price statement of work can be developed. In that case, a relatively small T&M or LH order for that interim period would be the most efficient way to proceed. Requiring a D&F for such small orders would eliminate this kind of flexibility. Accordingly, the Section recommends that there be abbreviated requirements for filing a D&F for contracts or orders below a certain dollar threshold. For example, the requirement to conduct market research could be eliminated for orders below the $100,000 limit set for the simplified acquisition threshold. *See* FAR 2.101; 48 C.F.R. § 2.101. Establishing a truncated D&F process for orders below a dollar threshold would be consistent with the Councils' discretion to implement SARA. *See Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984) (holding that an executive agency's construction of statutory scheme is entitled to considerable deference).

4. **Competition Requirements**

Section 1432 of SARA requires that T&M and LH commercial services be purchased "on a competitive basis." Echoing this requirement, the ANPR requires that the contract be awarded "using competitive procedures." The Section requests clarification that this requirement would be satisfied when task orders are issued using the FAR's "fair opportunity" requirements. FAR 16.505(b)(1); 48 C.F.R. § 16.505(b)(1). Otherwise, the new rules for commercial T&M and LH services might be construed to require the use of full and open competition, which ordinarily applies to contract awards, not task orders. *See* FAR Part 6; 48 C.F.R. Part 6.

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5. Answers to Questions Posed by the Councils in the ANPR

The ANPR poses a number of questions to assist the Councils in preparing new rules and contract clauses for T&M and LH commercial services. The Section responds to some of those questions below. Some of the questions posed in the ANPR, however, are not well suited for the Section to answer because they request industry-specific viewpoints and input.

a. What steps should a contracting officer be required to take to establish that a fixed-price contract is not suitable?

Section 1432 of SARA requires the contracting officer to determine that a fixed price contract is not suitable before purchasing T&M or LH services. The Section commends the approach taken by the Councils in the ANPR of requiring a contracting officer to conduct market research according to the procedures established in FAR Part 10 (48 C.F.R. Part 10). Because the contracting officer will be procuring commercial services, the descriptions and types of services the Government wants will likely be sold in substantial quantities in the marketplace and, therefore, already be well understood by both the Government and the contractors. Thus, the market research procedures in FAR Part 10 will be an effective way to determine whether it is feasible to purchase such services on a fixed price basis or a T&M or LH basis.

b. What responsibility should the contractor bear for correction of non-conforming services under T&M and LH commercial contracts (e.g., who should bear the cost of correction or re-performance)? Does the burden of responsibility depend on whether the Government has accepted the service?

As explained above, in most cases it is more consistent with commercial buying practices under T&M or LH contracts to pay for reperformance of deficient services or repair of defective goods. *See* FAR 52.246-6; 48 C.F.R. § 52.246-6. Thus, the contracting officer should have the ability to enter into contracts that provide for payments (not including profit) for reperformed services.

As an alternative approach, rather than having to compensate contractors for reperformance of defective work, the parties' respective allocation of contract risk can be adjusted to better approximate commercial practices. As mentioned above, standard practice in some industries is to establish cost estimates, not ceiling prices. These estimates are often not guarantees; neither party has the right to rely on the estimates, and the contractor does not have a duty to use "best efforts" to achieve a

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defined goal within the stated dollar amount.[1] Instead of the contractor using "best efforts" to perform the statement of work within the ceiling price, the contractor is obligated to perform the services according to the same performance standard provided in the contract warranty. So, for example, if the contract warranty provides that the services will be provided "in a professional manner consistent with industry standards" – a common warranty for commercial services in several industries – then the contractor would have to provide the services according to that standard until the ceiling price is reached. When the ceiling price is reached, the contractor could not continue working (unless the contracting officer raises the ceiling price) and would only be required to reperform the services that did not satisfy the contract warranty.[2]

Implementation of the commercial T&M and LH contract clauses in this way would better allocate the parties' contract risk so that it would be fair to require the contractor to bear the cost of correcting deficient performance.[3] The Government's interests are also protected by the competitive nature of the commercial services, that, by definition, are also widely offered in the commercial marketplace. The forces of competition give contractors an added performance incentive, thereby reducing the Government's risk in non-commercial contracts that unscrupulous contractors will "run up" the time or labor hours. This approach is

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[1] This is similar to the situation when the Government provides an estimate of the amount of work it will order under a given Indefinite Delivery Indefinite Quantity contract. The Government's estimate is no guarantee of the amount of work that will be ordered. Instead, the Government is merely required to order the minimum amount stated in the contract, and unless the estimate was prepared in bad faith, the contractor many not recover damages, no matter how great the difference between the minimum amount and the estimated total. *See, e.g., J. Cooper & Assocs. v. United States*, 53 Fed. Cl. 8 (2002), *aff'd* 2003 U.S. App. LEXIS 13088 (Fed. Cir. 2003).

[2] This solution also requires that the new contract clauses for T&M and LH commercial services permit the parties to replace the current warranty prescribed in FAR clause 52.212-4 with a warranty that is more suitable to commercial services. The current warranty in FAR clause 52.212-4 is better suited for the acquisition of goods rather than commercial services because it provides that *the items delivered* will be merchantable and fit for use for the particular purpose described in the contract. FAR 52.212-4(o); 48 C.F.R. § 52.212-4(o).

[3] This is commonly implemented in commercial T&M or LH services contracts in one of two ways:

- The services are accepted upon performance (or delivery if the contract calls for deliverables), in which case the Government, rather than rejecting the services for being deficient, would have a warranty claim, thereby obligating the contractor to reperform the deficient services at no additional cost to the Government; or
- The contract provides an acceptance period for the services, but (1) the standard for determining whether the services are deficient is the same standard that is provided in the warranty, and (2) the warranty's validity period is reduced by whatever amount of time is allocated to the acceptance period.

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also consistent with the statutory requirements set forth in SARA. SARA does not require the contractors to bear the risk of not being able to accomplish the work described in the contract under the ceiling price. Instead, it requires that a ceiling price be established so that a contractor that continues working past that point does so at its own risk. SARA § 1432 (amending FASA § 8002(d)(2)(B)(ii)).

c. *What oversight is used to ensure work is being properly charged under T&M and LH contracts (e.g., what type of information is required to substantiate payment requests)?*

The ANPR's draft payment clause gives the Government audit rights that are broader in significant respects than the audit rights provided under the standard non-commercial clause for T&M and LH services. The standard T&M and LH payment clause requires that contractors provide "invoices or vouchers and substantiating material." FAR 52.232-7; 48 C.F.R. § 52.232-7. The ANPR payment clause, however, goes further and is much more specific: it requires the contractor to provide access to the following for purposes of verifying labor hours: (1) the original timecards; (2) the contractor's timekeeping procedures; (3) contractor reports that show the distribution of labor between jobs or contracts; and (4) "employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices." Additional categories of information are specified for purposes of verifying material costs and subcontract costs.

The Section applauds the Councils' approach of being more specific with respect to the types of information that may be audited rather than merely repeating the vague "substantiating material" description. We do, however, have concerns with the requirement that contractors give the Government access to the contractor's employees to interview them regarding the hours they charged to the contract. This right, in our view, is substantially broader than the Government's rights under the existing T&M payment clause and is inconsistent with commercial business practices. Moreover, it is not necessary. In the absence of some indicia of fraud or wrongdoing, the employees' timecards will be sufficient evidence of the hours actually worked. Indeed, due to the time and expense conducting interviews would entail, in practice, the Government would likely interview employees only when there was a basis to investigate alleged wrongdoing. In those cases, the Government would not need a contract clause to interview employees because the same information can be obtained through

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subpoenas that are issued pursuant to an investigative body's specific powers; *e.g.*, the Inspector General Act of 1978, as amended, 5 U.S.C. App.[4]

d. Is consent to subcontract required for subcontracts not identified in the original proposal?

The Section agrees with the ANPR's requirement that contractors obtain the contracting officer's consent to subcontract, and with the procedures in the ANPR to obtain such consent. When professional services are being purchased on a T&M or LH basis, the Government should know what entity is providing the services. We suggest, however, that the requirement to obtain consent to subcontract be clarified to make clear that it applies only to charges that are directly charged to the contract, as opposed to overhead expenses and general and administrative expenses. Many commercial companies have corporate-wide agreements with vendors to perform those functions.

e. How are material handling or subcontract administration rates charged under T&M commercial contracts? If material handling or subcontract administration rates are reimbursed based on actual rates, how can this be done without application of FAR Subpart 31.2?

With respect to material handling and subcontract costs, the Section shares the Councils' concern over avoiding the application of FAR Part 31 (48 C.F.R. Part 31), which establishes specific cost principles and procedures for determining the allowability of contractor costs. Wholesale application of FAR Part 31 to commercial services contractors would be inconsistent with the policy of procuring commercial items using practices customarily used in the commercial marketplace. *See* FAR 12.201; 48 C.F.R. § 12.201. Thus, we commend the Councils' recommendation that material handling costs be limited to direct costs, thereby precluding allowability of indirect material costs and, therefore, application of FAR Part 31.

With respect to subcontract costs, however, we do not believe it is necessary or in the Government's interest to limit subcontract costs to the contractor's actual cost of subcontracting where, as here, the work is awarded competitively. In other words, we believe it would be in the Government's interest in certain cases to allow contractors to mark-up their subcontractor's T&M or LH

[4] Moreover, in the absence of a subpoena, companies may be reluctant to expose an employee to potential personal liability and may have a duty to provide legal counsel to the employee upon request.

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service rates, but *only if*: (1) the amount of the mark-up is fully disclosed to the Government, and (2) the total rate, including the mark-up, does not exceed the contractor's own rate for the same services. This practice would not require application of FAR Part 31 because the contractor would not be applying any indirect costs. Nor would it implicate concerns regarding the prohibition on cost plus percentage of cost contracting because the contractor would be adding a fixed charge to the subcontractor's rates that is not based on cost. Moreover, any issues concerning cost principles are ameliorated by the fact that the work will be awarded competitively. Consistent with this reasoning, the FAR explicitly recognizes that cost and pricing data is not required when awards are based on adequate price competition. *See* FAR 15.403-1(b)(1); 48 C.F.R. § 15.403-1(b)(1).

Allowing contractors to mark-up the subcontractor's service rates would preserve the Government's ability on large projects to have a prime contractor, such as an IT services integrator, coordinate the work of several parties and shoulder the administrative burden of doing so. If the prime contractor were unable to mark up the subcontractors' rates, the prime contractor would have little incentive to undertake complex projects that involve managing the work of several parties. The result would be that the Government would be unable to avail itself of the expertise large commercial contractors have in managing large complex projects.

f. What is the impact if Cost Accounting Standards apply to these contracts?

The Section recommends that the Cost Accounting Standards ("CAS") be amended so that commercial services purchased under T&M or LH contracts are exempted from CAS coverage. CAS regulations prescribe certain types of contracts that are exempt from CAS coverage. 48 C.F.R. § 9903.201-1. Currently, fixed-price and fixed-price with economic adjustment contracts for commercial items are exempt, but T&M and LH commercial services are not. *Id; see also* FAR 12.214; 48 C.F.R. § 12.214. We believe that including within the exemption commercial services purchased under T&M and LH terms would be consistent with the original intent to exclude commercial items from coverage. We further believe that application of CAS to T&M or LH commercial contracts is not only unnecessary, but would have adverse consequences to the commercial services contractors and to the Government. Commercial contractors that sell exclusively in the commercial marketplace most likely do not have accounting systems configured to comply with CAS. Reconfiguring a company's entire accounting architecture to comply with CAS would require substantial investment and would likely also require significant internal policy and organizational changes. If accepting T&M or LH orders for commercial services requires previously exempt

2003-027-1

contractors to comply with CAS, those contractors may decline to perform any commercial services on a T&M or LH basis. Accordingly, the Section recommends that the exemption for commercial items be extended to include commercial services that are purchased on a T&M or LH basis.

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

Patricia H. Wittie

Patricia H. Wittie
Chair, Section of Public Contract Law

cc: Hubert J. Bell, Jr.
Robert L. Schaefer
Michael A. Hordell
Patricia A. Meagher
Mary Ellen Coster Williams
Norman R. Thorpe
Council Members
Co-Chairs and Vice Chairs of the
Commercial Products and Services Committee
David Kasanow

2003-027-2

Elaine.Wheeler@dot.gov
11/16/2005 04:45 PM

To farcase.2003-027@gsa.gov
cc Wayne.Leong@dot.gov
bcc
Subject RE: DOT Comments on FAR Case 2003-027

The Department of Transportation provides the following comments to FAR Case 2003-027, Proposed Rule on Additional Contract Types.

With regard to the comment and response to 13d, we have two concerns.

1. Blanket allowance to pay the contractor for re-performance of work. In a number of jobs, there is recognition that the contractor under a T&M contract has wide leeway to work "using best efforts" to accomplish the task under the contract. "Best efforts" does not mean merely a good old "college try". The contractor can spend as much time as needed to accomplish a job right, either within the ceiling or the revised ceiling. The contractor would conceivably check and double check the work. If and when the service is completed and presented as such to the Government, there is an expectation that the job was properly accomplished. The contractor is under less budgetary pressure to perform under a T&M than under an FFP, and should be held to as stringent a quality standard. Further, payment for rework does not discourage the contractor from shoddy work, as additional payments, though without profit, would still at least cover direct labor and overhead costs.

2. 10 percent amount removed from labor rates. We are also concerned with the removal from labor rates of 10 percent for profit where rework is required. We agree that, if it is necessary to pay for rework, profit should not be allowed. While we understand that the 10 percent applies unless the contracting officer specifies otherwise, we believe this provision may have the unintended consequence of establishing 10 percent as a defacto standard for profit under T&M contracts. This amount may be excessive considering it is a contract type having the lowest level of risk or it could signal to contracting officer's that a 10 percent profit objective on T&M contracts is the norm. We believe a rationale needs to be provided that justifies why 10 percent is a reasonable figure. Perhaps historical data can indicate what is normally negotiated on T&M contracts across the Government or some other measure can be used to determine an appropriate percentage.

If you have any questions pertaining to the above comments, please let me know.

Elaine Wheeler
Associate Director, Acquisition Policy

Office of the Senior Procurement Executive
elaine.wheeler@dot.gov
(202) 366-4272

2003-027-3

November 23, 2005

Attention: Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, NW
Room 4035
Washington, DC 20405

Subject: Request for comments to FAR Case 2003-027
Use of Time-and-Materials (T&M) and Labor-Hour (LH) Contracts for Certain Categories of Commercial Services

Gentlemen:

Environmental Systems Research Institute, Inc. (ESRI) appreciates the opportunity to provide comments for your consideration regarding the above-referenced proposed rule. ESRI is a California corporation with its headquarters in Redlands, California and regional offices located throughout the United States. Our organization is the industry and worldwide market share leader in the field of Geographic Information Systems (GIS). Our software and services support diverse applications in commercial organizations, state, local, and federal governments as well as international entities.

Background
While software represents the largest component of our business, we routinely sell professional services associated with the implementation of our software and GIS technology to support our clients. Services are provided through all major contract types—firm-fixed-price, labor hour, cost reimbursable, and time-and-materials—depending upon the client's ability to define their requirements. Time-and-materials vehicles are utilized throughout federal, state and local government; private industry; and international organizations typically when these conditions exist:

- Client requires expertise of a consulting nature where the primary goal is to educate and transfer understanding of GIS technology
- Focus of the requirement is problem solving in nature where the solution is unknown
- Client has a requirement for application of leading-edge technology where minimal cost history exists
- Anticipated effort is less than $100,000 and deliverables are specified as labor hours

ESRI 380 New York St., Redlands, CA 92373-8100, USA · TEL 909-793-2853 · FAX 909-793-5953 · E-MAIL info@esri.com · WEB www.esri.com

2003-027-3

Comments
As the leading provider of GIS software and technology, ESRI has had significant experience working with a wide spectrum of agencies in the Federal Government. We have worked to make our users successful and in step with fast-paced GIS technology. Much of the technology transfer efforts have been achieved through time-and-materials awards within multiple award schedule contracts. This contract vehicle has allowed ESRI to work closely with our clients to educate, develop solutions, and assess their needs, which significantly supports progress toward their missions. Professional services and consulting of this nature mirrors support provided outside of the Government to commercial organizations.

As the intent of the 2004 Services Acquisition Reform Act (SARA) legislation is to streamline the procurement process and give the Government increased flexibility, it is our assessment that the Determinations and Findings process adds additional cost and a layer of administration without a commensurate level of cost benefit. While we understand the Government's duty to manage and mitigate risk, it is our perception that the proposed rule has a detrimental impact to its ability to tap into the knowledge base of industry technology experts.

Recommendation for Consideration
ESRI recommends that the Government consider revising its application of the Determinations and Findings process to more closely align the level of risk with the process as follows:

- Adoption of a threshold for a Determinations and Findings requirement for time-and-materials efforts that recognizes a reasonable level at which client tangible deliverables would be expected. **Recommendation: > $100,000**
- Develop an approval level commensurate with the risk to the Government

Professional services and consulting are critical to the Government's application of GIS and many technologies. To preserve access to these resources, appropriate contract vehicles that represent the industry standard should be available. The incorporation of additional administration to a rule that was intended to streamline does not represent "best value" concepts.

Thank you for the opportunity to comment.

Sincerely,

Jason Brouillette
ESRI Corporate - Federal

2003-027-4

"Belton, Clarence CIV
ASSTSECNAV RDA
WASHINGTON DC, DASN
AM"
<clarence.belton@navy.mil>
11/23/2005 11:11 AM

To farcase.2003-027@gsa.gov
cc
bcc
Subject FAR CASE 2003-027

Please consider the following comment under the subject proposed rule from Ms. Alma Edgerly.
-----Original Message-----
I am requesting that the following comment be submitted regarding FAR Case 2003-027, Additional Contract Types. Comments must be submitted **on or before 25 November 2005**.

FAR Case 2003-027

The proposed authority to use time-and-material (T&M) and labor-hour (LH) contract types for commercial services requires that the service be acquired under a contract awarded using competitive procedures. Please clarify in the final rule whether "competitive procedures" means that the service may only be acquired using "full and open competition" or whether the authority also extends to "other than full and open competition" when a competition is conducted with as many sources as practicable under one of the authorities listed in FAR 6.302. In other words, if I plan to acquire a commercial service under a contract awarded after a "limited competition" which uses competitive proposals, would this satisfy the requirement to use "competitive procedures"?

Thank you very much.

Alma Edgerly

2003-027-5

"Tuttle, Peter"
<PeterT@distributedinc.com>
11/25/2005 10:33 AM

To farcase.2003-027@gsa.gov
cc "Falcone, Ron" <RonF@distributedinc.com>
bcc
Subject FAR Case 2003-027 Additional Contract Types

Dear Ms. Duarte:

Distributed Solutions Inc. (DSI) is a small business founded in 1992 in Northern Virginia specializing in the manufacture of a robust electronic contract management software solution suite of products called the Automated Acquisition Management System (AAMS). AAMS is currently deployed in more than fifteen federal agencies.

First of all, thank you for the earlier opportunities to provide comments and to attend the public meetings on this important proposed rule. The following are our additional comments concerning the proposed rule:

1. FAR 52.212-4, para (i)(4) access to records. The clause language should take into account that many companies utilize electronic timekeeping systems instead of paper-based systems. The term "original timecards" used in the proposed language should be defined broadly enough to encompass both paper-based and electronic timecards. Government officials should accept a company's electronic record as an original and not insist on the generation of an additional (duplicative) paper copy that contains original signatures.

2. 10/18/2005 Public Meeting, Chart 16, Additional Input Sought on Authorized Use. The Councils expressed an interest in learning how prices are established when the general public uses T&M/LH Contracts. DSI, as a small business software manufacturer uses T&M infrequently and as a last resort to obtain services for short-term company requirements that are somewhat fluid or ill defined. In each case, DSI negotiates the hourly rate(s) and establishes the number of hours per labor category and a total not-to-exceed (NTE) amount for the work to be performed. These T&M efforts are also subject to a strict oversight process which is performed by company project managers who are accountable for the successful completion of the work. Any requirements for follow-on efforts are formulated as firm-fixed price orders with defined statements of work.

Please call either Ron Falcone or Peter Tuttle at (703) 471-7530 if you have any questions or require additional input.

Thanks.

Peter Tuttle, CPCM
Distributed Solutions, Inc.

2003-027-6

"Loiselle, Colleen (USANH)" <Colleen.Loiselle@usdoj.gov>

11/30/2005 07:23 AM

To farcase.2003-027@gsa.gov

cc

bcc

Subject I concur.

2003-027-7

DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PPD 710.5.7

December 8, 2005

MEMORANDUM FOR GENERAL SERVICES ADMINISTRATION, REGULATORY SECRETARIAT (VIR)

SUBJECT: DCAA Comments on FAR Case No. 2003-027 Additional Contract Types – Commercial Time-and-Materials/Labor Hours Contracts

We have reviewed the proposed revisions to the FAR coverage related to the subject case published in the Federal Register under FAR Case No. 2003-027. Based on our review of the proposed rule, we provide the following comment.

The proposed revisions are to implement Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 which authorizes the use of time-and-materials (T&M) and labor hour (LH) contracts for certain categories of commercial services under specified conditions. These contracts will be awarded under the provisions of FAR Part 12, Acquisition of Commercial Items. An area of concern to us relates to the proposed FAR revisions providing for the reimbursement of subcontract costs billed by the prime contractor at the negotiated contract labor rate instead of at cost. This particular provision is similar to the amendments currently being considered for noncommercial T&M contracts under FAR 52.232-7 (FAR Case No. 2004-015).

By their nature, T&M/LH contracts provide no positive profit incentive to the contractor for cost control or labor efficiency. We believe the proposed policy to allow subcontractors to be reimbursed at the negotiated rates for the prime contractor, rather than at cost, will incentivize contractors to maximize profits by subcontracting out more of their effort at lower subcontractor rates/costs and result in the Government paying higher costs than it otherwise would if the subcontracted effort was reimbursed at cost. This can occur because once the contract schedule rates are negotiated between the Government and the prime contractor, and named subcontractors are approved by the contracting officer, the prime contractor could then negotiate lower rates with those subcontractors. The Government would be billed at the negotiated contract schedule rates and the prime contractor would recognize as profit the difference between the billed amount and what was actually paid to the subcontractor.

Given the potential for increased profits, the prime contractors are also incentivized to maximize the subsequent level of use of these lower cost subcontractors to further increase prime contractor profits. While we recognize that the proposed regulatory changes provide authority for contracting officers to approve and limit subcontractors that are authorized to be paid at the contract schedule labor hour rates, this authority does not mitigate the risk that contractors will be allowed to bill for subcontractor effort at higher amounts than they incur themselves. As a result, the Government will always be at a greater risk of paying higher costs than what the prime

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contractor actually pays when acquisition policy allows for the reimbursement of subcontractor effort on T&M/LH contracts at other than cost.

We also believe that the Government would be required to expend additional resources to monitor the quality and efficiency of the subcontracted labor being provided in order to ensure that it was receiving the level of services that it had contracted for under the prime contractor, given that the visibility of the subcontracted effort would not be readily apparent when billed at the contract schedule rates.

In conclusion, we recommend reimbursing prime contractors for subcontracted effort at cost for the commercial T&M/LH contracts. This approach will continue to safeguard the Government's interests by avoiding paying excessive prices for subcontracted effort that may be of a level less than that envisioned by the Government when it entered into the contract.

We appreciate the opportunity to review and provide comments on the proposed FAR coverage. Please direct any questions on this matter to Mr. Wayne Goff, Chief, Policy Programs Division, at (703) 767-3280.

/s/ Terry M. Schneider
/for/ Earl J. Newman
Assistant Director
Policy and Plans

2003-027-8

Council of Defense and Space Industry Associations
1000 Wilson Boulevard, Suite 1800
Arlington, Virginia 22209
703-243-2020

December 9, 2005
CODSIA Case No. 05-07

Ms. Laurieann Duarte
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Washington, DC 20405

Subject: FAR Case 2003-027, Additional Contract Types

Dear Ms. Duarte:

The undersigned members of the Council of Defense and Space Industry Associations (CODSIA) appreciate the opportunity to offer comments on the proposed rule published in the *Federal Register* on September 26, 2005 (Volume 70, Number 185). On October 18, 2005, the Councils held a public meeting on this rule to discuss the implementation. Several members of the CODSIA Operating Committee attended the public meeting.

Formed in 1964 by industry associations with common interests in the defense and space fields, CODSIA is currently composed of six associations representing 4,000 member firms across the nation. Participation in CODSIA projects is strictly voluntary. A decision by any member association to abstain from participating in a particular activity is not necessarily an indication of dissent.

The proposed rule is intended to implement § 1432 of the National Defense Authorization Act of 2004, the "Services Acquisition Reform Act of 2003 (SARA)." SARA amended § 8002(d) of the Federal Acquisition Streamlining Act of 1994 ("FASA") to expressly authorize the use of time-and-materials (T&M) and labor-hour (LH) contracts for certain categories of commercial services under specified conditions. On September 20, 2004, the Councils published an Advance Notice of Proposed Rulemaking (ANPR); on November 23, CODSIA submitted comments on the ANPR, noting, among other things, that Time and Material (T&M) contracting allows for a rapid response and is administratively simple for both the buyer and the seller. We stated that T&M contracts are particularly useful when the scope of work cannot be definitively established to permit a firm-fixed price proposal, highlighting that the customer will pay only for the effort required and both parties know that the services can be terminated or extended at the customer's discretion. That CODSIA letter is attached.

A second set of comments, submitted on November 24, 2004 from four associations, noted our support for the FAR Council's determination to avoid applying the cost principles and broad audit rights in the contemplated contract clauses. Our letter noted that there are proposed FAR changes, such as the requirement to obtain contracting officer consent to subcontract, that overreach

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requirements, while other aspects do not go far enough to implement the statutory authority provided in SARA. Finally, that letter stated that the statute is clear that the cost accounting standards do not apply to T&M contracts for commercial services that meet the requirements of the law. That letter is available at http://www.pscouncil.org/pdfs/TMContractsComments112404.pdf.

This FAR Case 2003-027 focuses on T&M/LH contracts for *commercial items.* On September 26, 2005, the Councils published a companion proposed rule that, among other things, focused on T&M/LH contracts for *non-commercial items* (FAR Case 2004-015). Although some issues are common to both proposed rules, our comments in this response are limited to T&M/LH contracts for *commercial items.* CODSIA's comments on FAR Case 2004-015 are submitted separately.

In a number of areas, this proposed rule simply imports into this *commercial items* regulation many of the terms and conditions already used by the Government when purchasing *non-commercial* T&M/LH contracts. However, this action results in the inclusion in this *commercial items* rule of provisions that are a significant departure from standard commercial practices, contrary to the spirit of FASA and in violation of the requirement in FAR 12.301(a)(2) that commercial item contracts "include only those clauses … [d]etermined to be consistent with customary commercial practice." In addition, we are strongly opposed to several of the formulations proposed in this rule.

As a result, CODSIA does not support the rule in its present form. We strongly recommend that the Councils reconsider the entire approach to T&M contracting for commercial items and the expansive rulemaking contained in this proposal.

In addition to submitting these specific comments, we strongly recommend and request that the Councils schedule additional public sessions to discuss all of the public comments that have been submitted on the rule and provide the public with an additional opportunity to further explain the comments submitted.

Thank you for your consideration of these views. If you have any questions about our comments, please contact either of our project officers for this case: David Dempsey of Holland and Knight, who can be reached at (703) 720-8657 or at david.dempsey@hklaw.com or Alan Chvotkin of the Professional Services Council, who can be reached at (703) 875-8059 or at Chvotkin@pscouncil.org

Sincerely,

Chris Jahn

Alan Chvotkin

Chris Jahn
President
Contract Services Association

Alan Chvotkin
Senior Vice President & Counsel
Professional Services Council

2003-027-8

Dan Heinemeier
President – GEIA
Electronic Industry Alliance

Peter Steffes
Vice President, Government Policy
National Defense Industrial Association

Cynthia Brown
President
American Shipbuilders Association

Robert T. Marlow
Vice President, Procurement & Finance
Aerospace Industries Association

Attachments

CODSIA COMMENTS ON FAR CASE 2003-027

Our detailed comments on the rule are below, divided into two sections: "Major Issues" with provisions in the rule and "Additional Issues," in no order of priority. Together with the cover letter, they constitute our position on the proposal.

I. Major Issues

A. Inspection/Acceptance

All but one element of this proposed "inspection and acceptance" clause – the default profit rate-- is already included in current FAR 52.246-6, Inspection and Acceptance – Time and Materials and Labor Hours, relating to *non-commercial* items. Yet each of the provisions, when applied here, contains significant departures from terms typically found in the commercial marketplace.

Furthermore, the additional element not included in the current FAR 52-232-7 Payment Under Time and Materials and Labor Hour Contracts clause is the default profit rate of 10% provided for in proposed 52.212-4(a)(4). This default figure is inserted because contracting officers will not necessarily know the proposed profit in competitive awards. *(See* 70 Fed. Reg. 56331) Such a provision is highly unusual in commercial procurements. Even in the Federal marketplace, in our view it is irrelevant if the contracting officer knows the contractor's profit rate. Furthermore, if a contractor is expending best efforts and still not performing properly, the contracting officer could terminate the contract or retain another contractor to complete the work as provided for in FAR 52.246-6(f) and (g) [the provisions related to re-performance at no profit under the current inspection clause for T&M contracts].

Rather than adopt this formulation, CODSIA recommends that the Councils require contracting officers to better focus on the requirements of FAR 7.105, relating to the content of acquisition plans.

B. Definitions

1. Approved purchasing system

The Councils have changed – without explanation – the current rule that prohibits two types of contractors from obtaining approved purchasing systems: (1) FFP/ FFP with EPA contractors and (2) commercial item/services contractors. As proposed, commercial item contractors who perform FFP/ FFP with EPA contracts would be the only class of contractor that can never obtain an approved purchasing system. In other words, T&M/LH contracts for commercial services are required to have more oversight in terms of subcontractor approval and approval of subcontract modifications than other classes of contractors. Until this version of FAR 12.216 was proposed, such contractors were

exempt from the subcontract approval process – an exemption supported by FASA and FARA.[1] We oppose the expanded coverage of this provision.

2. Consent to subcontract

FAR 44.201-1 sets forth subcontract approval requirements. FAR 52.244-2 is a required clause for T&M subcontracts in excess of $100,000 pursuant to FAR 44.204(a)(1)(iv). However, other than the artificial separation of *commercial* from *non-commercial* T&M contracts, this proposed section on subcontractor consent appears completely unnecessary.[2]

CODSIA does not object to appropriate subcontractor disclosure requirements where they already existed for T&M contracts. *See* FAR 44.201(b)(1).[3] We do not believe it appropriate for the Government to interject its authority over the prime contractor's determination of how to accomplish the work being bid and awarded. In the commercial world, sellers are generally free to delegate their duties to subcontractors as they may see fit, unless the work is of a "personal services" nature – that is, work is a type for which the seller's personal attributes can be expected to have been an important factor in the buyer's decision to retain the seller's services. In the Government world, an agency makes these determinations in the evaluation of a contractor's proposal and through oversight of awarded work.

Furthermore, we are concerned about the administrative burden imposed on both the Government and the contractor to ensure that subcontract costs are listed in the contract in order to be reimbursable at the hourly rates prescribed in the contract.

3. Direct Materials and Materials

The term "direct materials" is defined as those materials that enter directly into the end product or that are used or consumed directly in connection with the furnishing of the end product or service. The term "materials" is defined as (1) direct materials, including interdivisional transfers of supplies and services, (2) subcontracts for supplies and services, (3) other direct costs, and (4) applicable indirect costs. While we understand and appreciate the Councils' efforts to clarify the treatment of subcontracts and interdivisional transfers under commercial item T&M contracts, we believe lumping both within the definition of "direct materials" is unnecessary and will, in fact, increase the confusion for all parties. For this reason, many member companies believe that all

---

[1] FAR 12.102(c) states: "When a policy in another part of this chapter is inconsistent with a policy in this part, this Part 12 shall take precedence for the acquisition of commercial items." Therefore, prior to the proposed FAR 12.216, contractors performing commercial items and services under a T&M or LH contract were exempt from the subcontractor approval process in FAR 44.201-1.

[2] According to FAR guidance and the FAR clause, "subcontractor approval" is a function of whether the prime contractor has an approved purchasing system. *See* FAR 44.2 and FAR 52.244-2. Subcontractor approval has long been viewed as straightforward contract administration. Consequently, the Councils' rationale for proposed 12.216 (*i.e.*, the "sanctity of the best value determination") regarding subcontractor approval appears misplaced.

[3] However, the Councils appear to have again exceeded the authority of SARA § 1432 and are using this case to address a perceived problem of "subcontractor substitution." *See* 70 Fed. Reg. 56327. Such "problems" were neither disclosed nor discussed in the Supplementary Information provided by the Councils. We believe alternative approaches are available to address this "perception."

subcontracted labor should be reimbursed under the labor portion (i.e., fixed hourly rate) of the contract and not treated as "material."

4. Subcontracts

The term "subcontract" is defined as any contract, as defined in FAR Subpart 2.1, entered into by a subcontractor to furnish supplies or services for performance of the prime contract or a subcontract. For commercial item contracts, the definition needs to be expanded to include the guidance provided at FAR 12.001, so that it is clear that subcontracts include transfers of commercial items between divisions, subsidiaries, or affiliates of a contractor or subcontractor (hereafter referred to as "interdivisional transfers").

Under the proposed rule, subcontracts and interdivisional transfers may fall under both the labor and material portions of the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause. The only distinguishing feature proposed by the Councils is that, as "direct materials," subcontracts and interdivisional transfers would be reimbursed under the labor portion (i.e., fixed hourly rate) of the contract. However, if either item is not considered to be for "direct materials," such reimbursement would have to be considered as being made under the material portion (i.e., actual cost) of the contract. Further complicating the definitional problems that might be created by the proposed rule is that the Federal Acquisition Streamlining Act (FASA) specified that interdivisional transfers for commercial items are to be treated as subcontracts (*see* FAR 12.001).

C. Payments

The Councils propose a bifurcated payment policy for subcontracts. For subcontractors expressly listed in proposed paragraph (ii)(B)(2) of the payments provision, the prime contractor would be paid for subcontractor incurred hours at the fixed hourly rates prescribed in the schedule. For subcontractors not expressly listed in paragraph (ii)(B)(2), the contractor would be reimbursed under paragraph (ii)(C) at actual costs (less any rebates, refunds, or discounts received by or accrued to the contractor). We have a number of concerns with the proposed payment provision.

1. Subcontracts

While we understand and appreciate the Councils' efforts to clarify the treatment of subcontracts and interdivisional transfers under commercial item T&M contracts, we believe lumping both within the definition of "direct materials" is unnecessary and will, in fact, increase the confusion for all parties. For this reason, many member companies believe that all subcontracted labor should be reimbursed under the labor portion (i.e., fixed hourly rate) of the contract, and not treated as "material."

We believe the Councils should use this historic opportunity to create separate sections within the payments provision for subcontracts and for interdivisional transfers (i.e., creating paragraph (iii) "Subcontracts" and paragraph (iv) "Interdivisional Transfers"). In this way, the payment policies intended by the Council for subcontracts and interdivisional transfers can be properly segregated and clarified for all parties. It would also avoid the inevitable disputes over whether a subcontract should be treated as "labor" or "material."

The payment policy needs to take into account the dynamic nature of T&M/LH contracting. After all, it is well recognized that such contracts are most appropriately used when it is not possible at the time of award to estimate accurately the extent or duration of the work (*see* FAR 16.601(b)). This may also be true for identifying subcontractors that would ultimately be used to perform the work. For example, several member companies note that they provide "on-call" or "on-demand" services and are not able to predict at the time of award which subcontractors will be called upon to fulfill such requirements. To the extent that new subcontractors would be needed, the attendant administrative processes under the proposed rule might impede the contractor's ability to deliver such services in accordance with the terms of the contract.

It is unfair to require the contractor to perform such services without knowing in advance whether the necessary subcontractors can be brought to the task and how the contractor will be reimbursed. The structure of the proposed rule would be difficult to establish and maintain throughout contract performance, and it would almost certainly impact the Government's efforts to review invoices submitted for payment. In addition, the structure of the proposed rule significantly increases the risk on the contractor for meeting contract deliverables because of the combination of the "consent to subcontract" provisions and the payment limitations. Any minor advantages of this proposed change to the Government would be negated by the administrative problems associated with establishing and maintaining the list of subcontractors whose costs would be treated as direct labor and the increased risk of contract execution because of these increased administrative and financial burdens. By its very nature, a fixed price contract shifts the risk of performance at that rate to the contractor.

While we do not oppose the appropriate subcontractor disclosure requirement, making it part of the "Payments Under Time-and-Materials and Labor-Hour Contracts" clause may work against all parties, especially when subcontractors not initially listed are needed to perform the work. We believe a more flexible approach that does not require formal contract modifications should be used. At the public meeting on the proposed rules, Council members present expressed a willingness to consider alternative formulations that would permit notification to the contracting officer without the need for formal contract amendments. We look forward to working with the Councils on developing an appropriate alternative formulation.

2. Interdivisional Transfers

The proposed rule allows the contractor to be reimbursed for its own materials that meet the definition of a commercial item at FAR 2.101 at the contractor's established catalog or the market price. The price is to be adjusted to reflect the quantities being acquired and actual cost of any modifications necessary because of contract requirements. So that future problems are avoided, we urge the Councils to make clear that "own materials" includes services.

We do not believe it is appropriate to base reimbursement of modifications on actual costs incurred other than what is now required at FAR Subpart 15.4. Commercial item pricing contemplates being able to establish a fair and reasonable pricing using price analysis techniques that do not depend on cost data. The goal is to seek prices paid by other commercial customers for same or similar products and services. The submission of cost data is contrary to the underlying policies and practices for the acquisition of commercial items under FAR Part 12.

We were pleased to see that there is no requirement for "most favored customer" pricing. Not only is the "most favored customer" requirement a barrier to market entry for member companies, it has long been inconsistent with the Government pricing policies contained in FAR Subpart 15.4. The "most favored customer" provision at FAR 16.601(c)(3)(iv)(B) should be eliminated, as well.

3. Material

The contractor would be reimbursed for material at actual costs (less any rebates, refunds, or discounts received by or accrued to the contractor). Our concern with this provision is similar to the concerns raised about the requirement for billing at the actual costs of modifications. A commercial item contract does not rely on cost accounting information. Most materials in a commercial item contract can be adequately supported with purchase orders, vendor invoices, and other such documentation, and thus eliminates the need to rely on accounting records. However, in other cases, references to accruals and other cost accounting data is not appropriate. For example, the provision implies that contractors will accrue rebates, refunds, and discounts. For commercial companies, such accruals, even if made, are typically identified to specific projects, especially if such credits are earned on more global considerations (e.g., total volume of purchases).

In addition, with respect to the provision in (ii)(A)(2) for the contractor who furnishes its own materials that meet the definition of a "commercial item" under FAR 2.101, we recommend striking the phrase "actual cost" and inserting the word "price".

4. Indirect Costs

The proposed rule indicates that indirect costs (e.g., material handling, subcontract administration, etc.) will be reimbursed on a pro-rata basis over the period of contract performance at an established fixed price. We agree with this provision. We suggest that it be made clear that the fixed price would be adjusted as new work is added.

5. Total Cost

The proposed rule established a notification procedure much like the limitation of cost and limitation of funds clauses now contained in certain contracts for noncommercial items. As this issue involves contracts for commercial items, we suggest that the provisions refer to "Total Price."

D. Access to Records and Audit Rights

The proposed rule grants the contracting officer, at any time before final payment under the contract, access to the following: (i) records verifying that employees whose time has been included in any invoice meet the qualifications for the labor categories specified in the contract; (ii) for labor hours, when timecards are required as substantiation for payment: (A) original timecards; (B) contractor's timekeeping procedures; (C) contractor records that show the distribution of labor between jobs or contracts; and (D) employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices, and (iii) for material and subcontract costs that are reimbursed on the basis of actual cost: (A) any invoices or subcontract agreements substantiating material costs; and (B) any documents supporting payment of those invoices.

While we recognize the need to support billings submitted to the Government for payment, the proposed rule significantly exceeds customary commercial practice. In fact, it exceeds the requirements of the existing payment provisions. Obviously, there is no authority in SARA § 1432 for this approach, a fact recognized by DCAA in the April 9, 2004 "GSA Schedule" Memorandum.[4]

In addition, we are particularly concerned with the inappropriate provision that authorizes access to employees, although CODSIA agrees that the contracting officer should be able to confirm if a contractor's personnel met the qualification requirements for a position.

E. CAS Applicability

As stated in the public comments to the Advance Notice of Public Rulemaking, unless corrected, we believe there will be a major problem with the interrelationship between this rule and the cost accounting standards rules. *See* FAR 9903-301-1(b)(6). Legislatively, Congress exempted contracts and subcontracts for the acquisition of commercial items from cost accounting standards (CAS) coverage. The CAS Board, however, only exempted firm fixed-priced contracts and fixed-price contracts with economic price adjustment (provided that price adjustment is not based on actual costs incurred) and subcontracts for the acquisition of commercial items. Since a T&M contract is neither a firm fixed-priced contract nor a fixed-price with economic price adjustment, it is conceivable that the T&M contracts now contemplated under FAR Case 2003-027 would be regarded as being CAS-covered. This would be completely unacceptable and untenable, and the possibilities for conflicts and disputes are obvious and inevitable.

The Councils' response is that revisions to CAS requirements are beyond the scope of FAR Case 2003-027 and that the Councils will forward the comments to the CAS Board for the Board's consideration. While we appreciate and agree that the FAR Council lacks the authority to make CAS changes, the magnitude of the risk associated with the ambiguity created by the rule raises significant concerns for our members. Especially in view of the fact that vacancies on the CAS Board and the absence of a Senate-confirmed Office of Federal Procurement Policy (OFPP) Administrator has left the CAS Board without a quorum and no ability to take action, the FAR Council should implement the statute and treat these T&M contracts as covered by the existing CAS exclusions.

F. Subcontract Consent

The proposed rule would add to commercial T&M/LH contracts a subcontract consent requirement patterned after FAR 52.244-2. (*See* proposed FAR 12.216 and 52.212-4, Alternate I, paragraph (u)). This subcontractor listing requirement provision could present a significant problem for commercial service providers and will lead to problems for the Government both in the evaluation of proposals and in the administration of the contract.

To the extent that the rule could be read to provide authority to the Government during contract administration to control the prime contractor's ability to substitute one qualified

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[4] DCAA wrote: "Based on the FAR provisions, it appears that orders issued under the GSA Schedule contracts constitute acquisition of commercial items, which are not subject to audit of contract performance costs." Memorandum for Regional Directors entitled "Audit Guidance on Review of Orders under GSA Schedule Contracts," 01-PAC-022(R), April 9, 2004.

subcontractor for another, the Government could be exposed to claims for delay or disruption when approvals are improperly denied or unreasonably delayed.

In justifying the provision, the Councils stated:

> When contractors add or substitute subcontractors after award, the basis for the best value determination used to award the contract may have been altered. Therefore, the Government must have the right to approve changes in subcontractors to maintain best value. As indicated by some of the comments, some commercial companies reserve the right to approve or deny changes in subcontractors. In fact, one commenter stated "the normal practice is that the contractor is not allowed to assign any portion of its responsibilities or rights under the contract without first obtaining the written approval of the client." The Councils do not believe subcontract consent will add significant administrative effort but will protect the Government from potential subcontractor substitution issues. (70 Fed.Reg. at 56327)

These concerns do not justify the provision that services supplied by subcontractors on an hourly basis are materials for which the prime contractor can only be reimbursed unless the prime contractor either lists the subcontractor in its proposal or gets the Contracting Officer to approve the use of the subcontractor at the contract rate after award. More properly, the question is not one of reimbursement but of Government payment for services received.

Finally, the Supplemental Information accompanying the rule states: "The Councils agree that the consent to subcontract applies only to costs that are directly charged to the contract and does not apply to overhead expenses and G&A expenses...Therefore, there is no need to provide additional language." We endorse this formulation; however, to avoid any future questions about the application of this provision, we strongly recommend that any final rule explicitly include such statement.

II. ADDITIONAL ISSUES

A. PART 2--DEFINITIONS OF WORDS AND TERMS

This provision amends FAR 2.101 in paragraph (b), in the definition of "commercial item", by removing the second sentence in the introductory text of paragraph (6). CODSIA agrees with this change because it is consistent with the authority set forth in SARA §1432.

B. PART 10--MARKET RESEARCH

This provision amends section 10.001 by removing from paragraph (a)(3)(iv) "as terms" and adding "as type of contract, terms" in its place. CODSIA agrees with this change because it assists in the implementation of SARA §1432.

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C. Part 12.207 – CONTRACT TYPE

CODSIA agrees with proposed 12.207(b)(1)(ii) because this section is authorized by SARA § 1432 and it implements the statute in a clear and concise manner. Consistent with our comment above, we recommend including a reference to FAR Part 10, Market Research.

D. D&F requirement

A determination and finding (D&F) is already required before entering into *non-commercial* T&M/LH contracts (*see* FAR 16.601(c)(1)). More importantly, SARA § 1432 authorizing the purchase of commercial services on a T&M/LH basis expressly requires that the contracting officer first execute a D&F establishing that "no other contract type is suitable." However, by specifying the minimum required contents for each D&F executed in support of a commercial T&M/LH procurement (*see* proposed FAR 12.207(b)(2)), the proposed rule imposes a potentially greater burden on contracting officers than the corresponding provision for non-commercial T&M/LH procurements at FAR 16.601(c)(1) that only requires a D&F "that no other contract type is suitable." We recommend striking all but the first sentence of proposed 12.207(b)(2).

Furthermore, CODSIA does not agree that each task order issued (*see* proposed (c)(2)) under an IDIQ contract requires a separate D&F and recommends that it be deleted. The D&F required by SARA §1432 is to justify the contract type, not the use of the contract once justified; the requirement for an order-by-order D&F under proposed (c)(2) is well in excess of the language and plain intent of SARA § 1432. There is no statutory basis or policy rationale to differentiate between the language in proposed paragraph (c)(3) that does not require an order-by-order D&F and the language in proposed paragraph (c)(2), which does require an order-by-order D&F.[5]

This proposed requirement has the effect of unnecessarily burdening contract administration and taking time away from the Government surveillance that is supposed accompany the decision to employ T&M contracting (*see* FAR 16.506).

E. Material Handling Fee

The Councils have revised the alternate Payments clause to allow the contractor to charge for material handling and/or subcontract administration, but at a fixed amount to be specified at the outset of the contract. The contractor would then be allowed to bill this amount on a pro rata basis over the period of performance. In the September 20, 2004 ANPR, the Councils offered a proposed Payments clause (subparagraph (i) of 52.215-4, Alternate I) that only allowed payment for the direct costs of materials and subcontracts, thus preventing the contractor from adding to these direct costs any indirect charge or other mark-up. CODSIA strongly opposed that prohibition in the ANPR and appreciates the Councils' recognition of the importance of permitting a contractor to charge for material handling and/or subcontract administration. In addition, we applaud the clarification included in the Supplemental Information that nothing in the rule prevents contractors from including a material handling amount in the fully burdened labor rates.

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[5] The Councils' explanation is that "the additional requirements [a D&F for each task order] are needed to encourage the preference for the use of fixed price contracts for commercial items as required by statute" (70 Fed. Reg.56323). However, this is inconsistent with the provisions in FAR 1.602-2 specifically providing that "contracting officers should be allowed wide latitude to exercise business judgment."

While there remains a significant question about the application of the statutory prohibition on the "cost plus percentage of cost" formulation, one possible solution would be to revise the proposed rule to permit the contractor to elect one of two alternative approaches to material handling/subcontract administration charges: (1) the fixed-charge, pro rata approach currently reflected in the proposed rule, or (2) a percentage mark-up, provided it is at a rate for which the contractor is approved to charge the Government on noncommercial work. Allowing the contractor the option of charging its approved rates for material handling/subcontract administration would solve the CPPC concern cited by the Councils, while protecting the contractor from any allegations of CAS non-compliance.

F. Types of Commercial Services Sold on a T&M Basis

We strongly support the Council's formulation relating to the types of commercial services sold on a T&M basis.

G. Termination

FAR 12.403(d)(1)(i), (ii) provides that the contractor shall be paid (1) for work performed prior to the notice of termination and (2) any charges the contractor can demonstrate resulted directly from the termination. For commercial supply or service contracts awarded under FAR Part 12, CODSIA believes this is sufficient guidance.

III. Conclusion

We are opposed to many provisions in this rule that are clearly inconsistent with commercial practices. Other provisions in the rule extend the Government's audit and oversight inappropriately and unnecessarily. As a result, CODSIA does not support the rule in its present form. We strongly recommend that the Councils reconsider the entire approach to T&M contracting for commercial items and the expansive rulemaking contained in this proposal. We appreciate the opportunity to comment on the proposed rule and renew our request for further public meetings to discuss this important proposed rule and the related commercial item proposed rule.

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2003-027-9

ITAA
Information Technology Association of America

December 8, 2005

Via E-mail
General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Room 4035
ATTN: Laurieann Duarte
Washington, DC 20405

Re: FAR Case 2004-015, Payment Under Time-and-Materials and Labor-Hour Contracts, 70 Fed. Reg. 56314 (September 26, 2005); FAR Case 2003-027, Additional Contract Types, 70 Fed. Reg. 56318 (September 26, 2005)

Dear Ms. Duarte:

The Information Technology Association of America ("ITAA") 1/ is pleased to submit these comments in response to the proposed rules dated September 26, 2005 to amend the Federal Acquisition Regulation (the "FAR") provisions applicable to time-and-materials ("T&M") and labor-hours ("LH") contracts. The proposed rules address both commercial item acquisitions (70 Fed. Reg. 56318) (hereinafter "the proposed Commercial Item Rule") and non-commercial item acquisitions (70 Fed. Reg. 56314) (hereinafter "the proposed Non-Commercial Item Rule"). Our comments focus mainly on the Commercial Item Rule, although the treatment of subcontracted labor is a critically important issue under both proposed rules and is addressed in Section I below.

The proposed Commercial Item Rule implements Section 1432 of the Services Acquisition Reform Act ("SARA") of 2004, which amended Section 8002 of the Federal Acquisition Streamlining Act ("FASA"), to authorize contracting for commercial services.

1/ ITAA provides global public policy, business networking, and national leadership to promote the continued rapid growth of the IT industry. ITAA consists of almost 400 corporate members throughout the U.S. and a global network of 67 countries' IT associations. The Association plays the leading role in issues of IT industry concern, including information security, taxes and finance policy, digital intellectual property protection, telecommunications competition, workforce and education, immigration, online privacy and consumer protection, government IT procurement, human resources and e-commerce policy. ITAA members range from the smallest IT start-ups to industry leaders in the Internet, software, IT services, ASP, digital content, systems integration, telecommunications, and enterprise solution fields. For more information visit www.itaa.org.

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Under FASA, services were considered commercial items based on having established catalog prices for specific tasks under standard terms and conditions. The statute created an issue, however, regarding whether Government agencies could use T&M contracts for commercial items. SARA addressed this issue by explicitly authorizing T&M contracting under specific circumstances.

ITAA is deeply concerned that the proposed Commercial Item Rule will undercut the intent of SARA by creating what effectively amounts to a prohibition on the use of T&M contracts. The proposed rule will add significant administrative burden, procedural complication, and certain significant financial disincentives concerning use of T&M contracts even where use of a T&M contract clearly furthers the Government's best interests, such as where the scope of work cannot be sufficiently defined up front to reasonably permit firm-fixed-price contracting. ITAA is similarly concerned regarding the proposed Non-Commercial Item Rule.

ITAA's comments are organized as follows:

Section I. Both the proposed Commercial Item Rule and Non-Commercial Item Rule are unduly restrictive regarding the treatment of subcontracted labor. The proposed rules will (i) impose substantial administrative burdens on both contractors and Government agencies; (ii) make it very difficult for the Government to acquire "on-call" and similar "on-demand" services; (iii) decrease prime contractors' incentive to add qualified subcontractors during performance, including qualified small and small, disadvantaged businesses that become known only during performance; (iv) destroy the motivation that many contractors currently have to offer their corporations' standard commercial solutions; (v) fail to appropriately compensate a prime contractor for costs incurred and financial risks associated with subcontracting; and (vi) otherwise inhibit the employment of the best qualified personnel on Government projects.

Section II. The proposed Commercial Item Rule's provisions regarding use of subcontracted labor, the determination and findings requirement, the right to compel contractor employee interviews, and time card requirements are unduly burdensome, inconsistent with customary commercial practice, and intrusive.

Section III. The proposed Commercial Item Rule's material handling provisions should be revised to afford contractors the flexibility to comply with commitments associated with their Cost Accounting Standards Disclosure Statements.

Section IV. ITAA agrees with the Office of Federal Procurement Policy's apparent conclusion that use of T&M and LH contracts should not be limited by a list of specific service categories.

Section V. The proposed Commercial Item Rule's warranty provisions are a significant improvement on the September 2004 advanced notice of proposed rulemaking.

Attachment ITAA's specific recommended changes to the proposed Commercial Item Rule are presented in the Attachment hereto.

Finally, ITAA would like to urge that further public meetings be held to discuss these proposed rules and their impact on the provision of commercial and non-commercial items to the Government. Of additional concern is the issuance of these rules prior to the completion of the report from the Acquisition Advisory Panel, which could cause a conflict between their recommendations and those included in these rules. We are also concerned over implementation of the proposed Commercial Item Rule before the Cost Accounting Board has issued appropriate waivers for commercial services performed under T&M or LH contracts. All of these parallel actions need to be examined and possibly addressed prior to the issuance of a final rule.

Our comments are discussed in detail below.

COMMENTS APPLICABLE TO BOTH THE PROPOSED COMMERCIAL ITEM RULE AND NON-COMMERCIAL ITEM RULE

I. The Proposed Rules' Treatment of Non-Prime Contractor Labor Is Unduly Restrictive.

Both the proposed Commercial Item Rule and the Non-Commercial Item Rule unduly restrict a prime contractor's ability to recover reasonable compensation for subcontracted labor and otherwise pose substantial administrative burdens that will likely cause significant procurement delays. Of greatest concern to ITAA, both proposed rules establish a default rule that treats subcontracted labor as "material" and treats as a "pass-through" cost (*i.e.*, no prime contractor mark-up to account for the prime contractor's services) the labor provided by every subcontractor not specifically identified in the prime contract. ITAA strongly believes that the FAR Councils' proposed approach on this issue in many instances would—

- pose substantial administrative burdens at the pre-award and post-award stages of an acquisition due to the need to negotiate and modify contracts to gain the Government's permission to charge prime contract rates for subcontract labor;
- make it extremely difficult for the Government to acquire "on-call" and similar "on-demand" services that sometimes require a single contractor to take responsibility for hundreds or even thousands of subcontractors –

often interspersed across a wide geographic area – through the life of the contract;

- decrease the incentive for prime contractors to add qualified subcontractors during contract performance, including adding qualified small and small, disadvantaged businesses that become known only during contract performance, because of the uncertainty of the prime contractor's ability to charge prime contract rates for the subcontract labor;
- destroy the motivation of many contractors' Federal Government divisions to offer the Government best value by taking advantage of their company's standard commercial services, because such offerings often entail an ever-changing pool of qualified subcontractors;
- fail to appropriately compensate contractors for the financial risk and potential liability it assumes by managing a pool of qualified subcontractors for the Government;
- often negate any reasonable business case for a contractor to perform a project on a T&M or LH basis, thereby leaving the Government with no choice but to use firm-fixed priced contracts that do not impose such restrictive requirements. This option will result in higher Government prices to account for risk contingencies required for performing work that may vary significantly in scope and volume; and
- otherwise inhibit the employment of the best-qualified personnel on Government projects.

ITAA urges the FAR Councils to reconsider their proposed approach because the Government significantly benefits from the use of subcontract labor and the risks associated with subcontracting for T&M and LH contracts is low.

ITAA members – who are both major providers and purchasers of services performed on a T&M or LH basis – perform a wide-variety of IT-related professional services for the Government on T&M and LH bases. Contractors frequently require use of subcontractors for any number of reasons, including: (1) to secure specific skill sets; (2) to augment an existing workforce; (3) to use small and/or small, disadvantaged businesses to meet socioeconomic goals; (4) to incorporate small business innovation into solutions; and (5) to replace a subcontractor during contract performance for failure to achieve the prime contractor's performance standards.

Any additional risk posed to the Government from a contractor's use of subcontractors is low. In ITAA's view, Federal agencies are cognizant of industry's use of subcontractors on T&M and LH (as well as other) contracts and have, on the whole, been satisfied. Importantly, purchasing agencies hold prime contractors solely responsible for nonconforming performance—whether the performance is by the prime contractor or a subcontractor. Subcontract performance issues are dealt with as any other performance issue, and the Government has available several contract remedies

for unsatisfactory performance, including those remedies provided by the Disputes clause.

The proposed provisions restricting the use of subcontractors seem to be a solution in search of a problem. The current practice of billing subcontracted labor at the prime contract labor rates—provided that the subcontract labor satisfies all prime contract qualification requirements—is appropriate, fair, and in the Government's best interests. However, if the FAR Councils do promulgate a rule on this issue, ITAA provides the following comments.

A. The Proposed Rules Should Define "Time" To Include All Labor Provided Under the Prime Contract—Qualified Subcontractor Labor Should Not Be Treated As "Material."

The proposed rules' definition of "Time" should encompass all labor provided under the prime contract, regardless of the labor's source; that is, the term should include the prime contractor's work force, inclusive of interdivisional transfers, as well as any subcontracted labor. Conversely, the definition of "Materials" essentially should cover costs other than those incurred as part of a contractor's "Time." Currently, however, the proposed rules define "Materials" to include "***services*** transferred between divisions, subsidiaries, or affiliates of the contractor under common control" and "subcontracts for . . . ***services***." The proposed approach is contrary to the traditional (and common sense) meaning of the term "materials." Moreover, this approach effectively establishes a default rule whereby contractors must treat subcontracted labor as a "pass through" cost. This treatment unreasonably precludes contractors from recovering adequate compensation for the time and resources it expends on administering subcontracts and for the financial exposure it assumes for a subcontractor's performance.

B. The Proposed Rules Should Permit Prime Contractors To Bill for Qualified Subcontract Labor Accepted by the Government at the Prime Contract Labor Rate Without the Unwieldy Imposition of Subcontractor Listing and New Subcontractor Consent Requirements.

The default rule should provide that contractors may bill at the prime contract labor rates for qualified subcontracted labor (*i.e.*, labor provided by subcontractor personnel who satisfy the prime contract's labor category qualification requirements). This rule should hold true regardless of whether or not the prime contract specifically identifies the subcontractor at the time of contracting.

There are generally two methods by which service offerings may be developed. Under the first method, the prime contractor provides a standard service that is available as a commercial offering. The contractor develops these offerings at the corporate level, and the corporation's federal sales team supporting the federal business may or may not even know of the existence or identities of subcontractors, or

changes to them. Also, the contractor's federal sales team very likely does not know the costs for those subcontractors. "On-call" IT installation and repair service contracts in support of commercial IT products are often performed in this manner—quite often on a T&M or LH basis.

Under the second method, the contractor provides a service in response to a unique Government agency requirement. The contractor's federal team typically develops the proposal for this type of service. While the anticipated subcontractors may be identified in the initial contract, each time a prime contractor identifies an additional subcontractor that is best capable of performing the required work, but is not listed in the prime contract, the prime contractor and the Government will be forced to seek a contract modification. This poses an excessive administrative burden on both parties in terms of both delay and resources. If a prime contractor's proposal is based upon charging the Government the prime contract labor rate ***for the type of work***, whether it is performed by the prime or subcontractor, the resulting contract should permit the prime contractor to charge the Government at that labor rate. This should be permitted regardless of whether or not the subcontractor performing the work has been identified in the prime contract – provided the subcontractor meets the applicable labor category requirements and the prime contractor remains responsible for its performance. 2/

Some commentators appear to have confused this issue with what is characterized as a bait-and-switch, in which a contractor promises the Government performance by an entity that formed the basis of the Government's award decision and then substitutes the performance of another entity without the Government's consent. That is ***not*** the issue at hand. Rather, ITAA is addressing the situation where a prime contractor's proposal indicates (1) that some of the work performed on the project may be performed by subcontractors that meet the contract's qualification requirements, but are not specifically listed at the time of contracting, and (2) that the prime contract's price ***for that type of work*** will be at the prime contract's labor rate, which may be a blended or other rate. With respect to point (1), unlike contracts that may simply require deliverables without regard to who will actually perform, LH and T&M contracts contain specific labor categories with specific qualifications. Whether a person filling a position on such a contract is employed by the prime or a subcontractor, the qualifications must be met.

As to point (2), whether the prime contract rates for labor are fair and reasonable for subcontracted labor is not an issue. By rule, the Government already has determined (through adequate price competition or otherwise) that the prime contract pricing is fair and reasonable for the type of work performed. Therefore, the Government is assured that qualified individuals will perform the services at fair and reasonable rates.

2/ Additional labor categories required during the course of contract performance should be handled through the normal contract modification process.

Ultimately, the Government holds the prime contractor accountable for performing the work, including any performance deficiencies. The proposed rules, however, will often work to preclude prime contractors from receiving adequate compensation for the administrative cost and financial risk of administering the subcontracts. This result is unfair and contrary to customary commercial practice.

C. The Subcontract Consent Provisions Are Unduly Burdensome.

T&M and LH contracts are intended for use only when a fully defined statement of work cannot be developed to support another contract type. The proposed rules will slow the procurement process and in many cases make expediency unobtainable. For example, the proposed provisions prohibiting a contractor from billing at the prime contract labor rates for subcontracted labor not specifically identified in the prime contract will result in lengthy contract negotiations at the outset of contract formation. These negotiations between the contractor and Government over what subcontractors may or may not be billed at the prime contract rate will be an invitation to dispute. In addition, a significant amount of additional administrative work will be required to add a subcontractor during contract performance, which will drain an already understaffed Government acquisition workforce.

The proposed provisions permitting contractors with approved purchasing systems to forego Government consent provide no assistance to the thousands of commercial businesses that do not have such systems in place. Moreover, the consent provisions even for those contractors that have such Government-approved purchasing systems provide little relief because the proposed rule still requires the contracting officer's approval to add subcontracted labor at the prime contract labor rates. Absent the contracting officer's approval and resulting contract modification to add the subcontractor, the contractor will be stuck billing for the subcontractor's effort as a pass-through cost, even though the contractor remains responsible for the subcontractor's performance. The proposed requirements will discourage use of subcontractors.

For the proposed Commercial Item Rule, ITAA urges the FAR Councils to revise proposed FAR 12.216 and FAR 52.212-4(u) (Alternate 1), to simply read:

> Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation.

ITAA's language is consistent with customary commercial practice (*see* FAR 12.301(a)(2), which requires that contracts include only those provisions determined to be consistent with customary commercial practice) and would remove the most significant impediments posed by the proposed rule.

ITAA also urges the FAR Councils to make a corresponding change to FAR 52.232-7(b)(4) of the proposed Non-Commercial Item Rule.

COMMENTS SPECIFIC TO THE PROPOSED COMMERCIAL ITEM RULE

II. The Proposed Commercial Item Rule Will Impose Significant Administrative Burdens.

The proposed rule's provisions regarding a contractor's use of subcontracted labor, the lack of a dollar threshold for the determinations and findings ("D&F") requirement, the Government's right to compel employee interviews, and the use of time cards amount to a framework that will prove unduly burdensome and will be inconsistent with customary commercial practice. ITAA's comments address the use of the subcontracted labor issue in Section I above; the remaining issues are addressed directly below.

Dollar Threshold for D&F Requirement. The proposed rule's requirement for a D&F stating that no other contract type is suitable before T&M or LH contracts shall be permitted, regardless of the contract's dollar value, is unduly burdensome. The proposed rule requires a D&F for every T&M or LH transaction ***no matter how small***. This approach will unduly restrict the Government's ability to efficiently procure commercial services. Contracting officers must often quickly issue small task orders for T&M or LH work. For example, time constraints and urgent circumstances may make it necessary for work to commence immediately instead of waiting until a suitable fixed-price statement of work can be developed. Requiring a D&F for such small orders severely limits this necessary flexibility. ITAA asks the FAR Councils to revise the proposed rule to exempt from the D&F requirements small purchases at or below the five-million-dollar threshold already existing under FAR 12.203 (applicable to commercial items), which permits agencies to use simplified acquisition procedures. ITAA's request is consistent with the FAR Councils' discretion to implement the statutory provisions addressing D&Fs. *See Chevron, U.S.A. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984).

Further, ITAA recommends that the FAR Councils consider changing the wording of proposed 12.207(b)(2)(ii), which requires that each D&F include sufficient details to "[e]stablish that it is ***not possible*** at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any degree of certainty." (Emphasis added.) At times, it may be ***possible*** for the Government to definitize its requirements to such an extent that one could reasonably estimate the duration and cost of the work needed to fulfill those requirements, yet doing so would be ***impracticable*** given the time and effort that would be required, the urgency of the work, and the agency's competing priorities. At a minimum 12.207(b)(2)(ii) should be revised to read: "Establish that it is ***not practicable*** at the time of placing the contract or order ...."

ITAA also recommends that the FAR Councils delete the proposed requirement for a D&F for each individual task order. We are concerned that this proposed requirement will unnecessarily delay acquisitions. A single D&F based on the contract's statement of work and covering the entire contract should constitute sufficient justification for task orders issued consistent with that contract's statement of work.

Compulsory Interviews of Contractor Employees. The proposed provision seeking to grant the Government a right to interview contractor employees regarding their work is unreasonably intrusive and contrary to customary commercial practice. Notwithstanding a statement made to the contrary in the commentary accompanying the proposed rule, no similar right exists in the FAR for any other contract type, including for FAR Part 15 non-commercial item cost-reimbursement, T&M, or any other form of contracts. The commentary accompanying the proposed rule stating that FAR 52.215-2, *Audit and Records-Negotiation*, provides for a similar right is inaccurate. Not even the Offices of Inspectors General under the Inspectors General Act ("OIG Act") have the authority that the FAR Councils now seek through the proposed rule.

In addition, the right to compel interviews of contractor employees conflicts with the Federal Acquisition Streamlining Act ("FASA"). 3/ FASA mandates that Government agencies rely to the maximum extent practicable on commercial products and services to fill their needs. FASA further requires that an agency revise, to the maximum extent practicable, its procurement policies, practices, and procedures that are not required by law to reduce impediments to the acquisition of commercial items. FASA also requires that commercial item contracts contain only those terms and conditions that are required by law or that are customary in the commercial marketplace. FAR 12.301(a) implements these requirements by limiting, to the maximum extent practicable, the terms and conditions that can be inserted into a commercial items contract to those terms and conditions that are required by law or are determined to be consistent with customary commercial practice. The right to interview a service contractor's employees is not customary—and is, in fact, very unusual—in the commercial marketplace. And considering that no similar requirement exists in the FAR or even in the OIG Act, it cannot reasonably be claimed that the imposition of anything less than this intrusive requirement would be impracticable.

Government Inspections. The proposed rule requires contractors and subcontractors to provide accommodations in connection with Government testing and inspections, including testing and inspections conducted at a contractor's or subcontractor's facility. The proposed rule does not address, however, the responsibility for costs incurred by a contractor or subcontractor in connection with this requirement. Fairness dictates that the Government reimburse contractors (and their subcontractors) for the reasonable costs they incur as a result of the required accommodations.

3/ Federal Acquisition Streamlining Act, Pub. L. No. 103-355, §§ 8002, 8104, Oct. 13, 1994.

Time Card Provisions. The proposed rule requires timecard substantiation of labor hours. Most service providers no longer use timecards to record labor hours. Most contractors instead use automated record keeping tools. ITAA recommends that the proposed rule be revised so that such automated record keeping tools are recognized as an alternative to time cards.

III. The Rules Should Allow Prime Contractors to Recover for Material Handling in a Manner Consistent with Contractors' CAS Disclosure Statements.

As currently worded, the proposed rule requires contractors that are committed to certain cost accounting practices prescribed in their Cost Accounting Standards ("CAS") Disclosure Statements to significantly change their CAS disclosure statements or perhaps keep a separate set of accounting books in order to recover their costs incurred in connection with material handling. Although the proposed FAR provision permitting companies to recover material handling costs on a pro-rated fixed-price basis satisfies many contractors' need to recover their material handling costs, it does not satisfy the need of contractors that must comply with CAS-disclosed practices. In addition to permitting commercial companies to recover their material handling costs on a pro-rated fixed-priced basis, the proposed rule should allow companies the flexibility necessary to comply with CAS-disclosed accounting practices.

Some contractors perform both commercial and traditional FAR Part 15 Government work within the same business unit and subject to a single CAS-disclosed practice. To comply with CAS, these contractors often have to allocate material handling costs in accordance with their Government-approved material handling rates. These contractors apply such rates on FAR Part 15 cost-reimbursement and T&M contracts. ITAA sees no reason why a contractor cannot similarly charge its material-handling rate under FAR Part 12 commercial T&M contracts.

In this regard, the FAR Councils have based the proposed rule apparently on a concern that material handling rates would violate the prohibition against cost-plus-a-percentage-of-cost contracts. We disagree with the conclusion that forms the basis of the concern. As indicated above, Government-approved material handling rates already are used on FAR Part 15 contracts. More importantly, a material-handling rate is a well-recognized method—both in the Federal and commercial markets—for allocating estimated costs incurred in the material handling function. A material handling rate does not add fee or any other price component to cost. It is a reflection of the contractor's actual costs, which of course should be reimbursed. ITAA requests that the FAR Councils consider including in the proposed clause the language that allows prime contractors to recover their reasonable cost provided they are excluded in hourly rates.

IV. ITAA Supports the Office of Federal Procurement Policy's Conclusion that Use of T&M and Labor Hour Contracts Should *Not* be Limited by a List of Specific Categories of Services.

Section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (P.L. 108-136) amended Section 8002(d) of the Federal Acquisition Streamlining Act to expressly authorize the Government's use of T&M and LH contracts for the procurement of commercial services. In this regard, the amendment authorizes the Administrator of Office of Federal Procurement Policy ("OFPP") to designate categories of services that agencies may procure on T&M and LH contract terms on the basis that (1) the commercial services in such category are of a type that are commonly sold to the general public through use of T&M or LH contracts, and (2) it would be in the best interests of the Federal Government to authorize use of T&M or LH contracts for purchase of the commercial services in such category. The commentary to the proposed Commercial Item Rule indicates that the OFPP has studied the issue and specifically found that commercial services are commonly sold on both T&M/LH and fixed-priced contract terms and has apparently concluded that it would serve no useful purpose to limit the use of T&M and LH contracts to a list of specific categories of services. For the reasons addressed below, ITAA agrees with this conclusion.

In the commercial marketplace, the determination on whether to use a T&M/LH contract or a fixed-price contract depends mainly on whether the contract requirements can be defined sufficiently up-front such that a reasonable basis exists for firm-fixed pricing. No general rule or practice exists that requires use of firm-fixed pricing based upon whether the purchased service falls within a limited list of specifically-defined categories of services. An informal survey of ITAA membership has confirmed that many types of services are purchased or provided by ITAA members in the commercial marketplace on ***both*** T&M and firm fixed-price terms depending on the circumstances of the particular project. If the work is not defined with a reasonable degree of certainty at the outset, or if the contractor may be required to ramp up or ramp down quickly as the volume of work changes, or if other characteristics of the project impose significant pricing risks, the project would likely be bid on a T&M or LH basis. When these circumstances exist, use of firm-fixed price contract terms would impose too much financial risk on both the service provider and customer.

Bottom line, although some types of services are procured in the commercial marketplace much more often on a T&M basis than other types of services—for example, on-call repair or installation services—there are no general rules or practices that restrict use of T&M and LH terms for any specific service category. There are often times, regardless of service type, that the work cannot be sufficiently defined at the outset to provide for meaningful firm-fixed prices.

Accordingly, a list constraining the procurement of commercial services on a T&M or LH basis to those services that are perceived to be procured commonly in the commercial market based on T&M or LH terms would provide little if any value considering that any such list would reasonably include an extremely wide array of services.

V. The Proposed Warranty Provision Constitutes a Significant Improvement over the Advanced Notice of Proposed Rulemaking and Properly Reflects Commercial Practice.

The proposed warranty provision set out in proposed FAR clause 52.212-4, (6) Alternate 1, is a significant improvement over the corresponding provision set out in the September 2004 advanced notice of proposed rulemaking ("ANPR"). The ANPR's proposed warranty provision would have required service providers to reperform nonconforming services under a limited warranty provision at no additional cost to the Government—an approach that would be inconsistent with customary commercial practice for most, if not virtually all, service types and that would impose greater risk on the service provider than the FAR non-commercial item clause. The proposed Commercial Item Rule provides some balance on this issue by requiring the Government to pay the service provider, less profit, for nonconforming work required to be reperformed (capped at the contract ceiling price). This approach bears a better resemblance to commercial practice and is consistent with the provisions for noncommercial T&M contracts at FAR clause 52.246-6. ITAA assumes that the parties will be permitted to tailor this provision pursuant to FAR 12.302 in those cases where the customary commercial practice for the specific type of service provides for different warranty terms.

****

ITAA appreciates this opportunity to provide its comments on this very important issue. Our comments set out above are not intended to be critical of the proposed rule, but are intended to foster the development of final rules that properly reflect the nature of T&M and LH contracts and allow these contract types to be used efficiently when the Government decides to rely on them.

ITAA would be pleased to respond to any questions the FAR Councils may have on these comments.

Respectfully submitted,

Harris N. Miller
President
Information Technology Association of America

027-9

ATTACHMENT

ITAA'S RECOMMENDED REVISIONS TO PROPOSED COMMERCIAL ITEM RULE

PART 2—DEFINITIONS OF WORDS AND TERMS

2.101 [Amended]

* * * * *

PART 10—MARKET RESEARCH

* * * * *

PART 12—ACQUISITION OF COMMERCIAL ITEMS

5. Revise section 12.207 to read as follows:

12.207 Contract type.

(a) Except as provided in paragraph (b) of this section, agencies shall use firm-fixed-price contracts or fixed-price contracts with economic price adjustment for the acquisition of commercial items.

(b)(1) A time-and-materials contract or labor-hour contract (see Subpart 16.6) may be used for the acquisition of commercial services when—:

(i) The service is acquired under a contract awarded using competitive procedures; and

(ii) The contracting officer—:

(A) Executes a determination and findings (D&F) for <u>each contract in excess of $5 million</u>, in accordance with paragraph (b)(2) of this section (but see paragraph (c) of this section for indefinite-delivery contracts), that no other contract type authorized by this subpart is suitable;

(B) Includes a ceiling price in the contract or order that the contractor exceeds at its own risk; and

(C) Authorizes any subsequent change in the ceiling price only upon a determination, documented in the contract file, that it is in the best interest of the procuring agency to change the ceiling price.

(2) Each D&F required by paragraph (b)(1)(ii)(A) of this section shall contain sufficient facts and rationale to justify that no other contract type authorized by this subpart is suitable. At a minimum, the D&F shall—:

(i) Include a description of the market research conducted (see 10.002(e));

(ii) Establish that it is not ~~possible~~ practicable at the time of placing the contract or order to accurately estimate the extent or duration of the work or to anticipate costs with any reasonable degree of certainty; and

(iii) Establish that the requirement has been structured to maximize the use of fixed price contracts (e.g., by limiting the value or length of the Time and Material/Labor Hour contract or order) on future acquisitions for the same or similar requirements.

(c)(1) Indefinite-delivery contracts (see Subpart 16.5) may be used when—:

(i) The prices are established based on a firm-fixed-price or fixed-price with economic price adjustment; or

(ii) Rates are established for commercial services acquired on a time-and-materials or labor-hour basis.

(2) When an indefinite-delivery contract is awarded with services priced on a time-and-materials or labor-hour basis, contracting officers shall, to the maximum extent practicable, also structure the contract to allow issuance of orders on a firm-fixed-price or fixed-price with economic price adjustment basis. For such contracts, the contracting officer shall execute the D&F required by paragraph (b)(2) of this section~~, for each order placed on a time-and-materials or labor-hour basis.~~ Placement of orders shall be in accordance with Subpart 16.5.

(3) If an indefinite-delivery contract only allows for the issuance of orders on a time-and-materials or labor-hour basis, the D&F required by paragraph (b)(2) of this section shall be executed to support the basic contract and shall also explain why providing for an alternative firm-fixed-price or fixed-price with economic price adjustment pricing structure is not practicable. The D&F for this contract shall be approved one level above the contracting officer. Placement of orders shall be in accordance with Subpart 16.5.

(d) The contract types authorized by this subpart may be used in conjunction with an award fee and performance or delivery incentives when the award fee or incentive is based solely on factors other than cost (see 16.202-1 and 16.203-1).

(e) Use of any contract type other than those authorized by this subpart to acquire commercial items is prohibited.

6. Add section 12.216 to read as follows:

12.216 Subcontracts.

(a) Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation. ~~When a time and materials or labor hour contract is awarded pursuant to 12.207(b), Alternate I to the clause at 52.212-4 is used. Alternate I includes a subcontract consent provision that requires the contractor to obtain the contracting officer's consent prior to awarding certain subcontracts.~~

~~(b) When the contractor has an approved purchasing system, the contracting officer shall identify, in an addendum to the clause, those subcontracts that will require consent.~~

~~(c) When the contractor does not have an approved purchasing system, the contracting officer shall identify, in an addendum to the clause—:~~

~~(1) Those subcontracts reviewed during proposal evaluation for which consent is not required after contract award;~~

~~(2) Those subcontracts for which consent is not required by the clause, but which the contracting officer has determined that an individual consent action is required to protect the Government; and~~

~~(3) Any other exceptions to the standard consent requirements.~~

~~(d) The contracting officer shall consider the risk, complexity and dollar value of anticipated subcontracts when determining the consent requirements.~~

7. Amend section 12.301 by revising paragraph (b)(3) to read as follows:

12.301 Solicitation provisions and contract clauses for the acquisition of commercial items.

* * * * *

(b)* * *

(3) The clause at 52.212-4, Contract Terms and Conditions—Commercial Items. This clause includes terms and conditions which are, to the maximum extent practicable, consistent with customary commercial

practices and is incorporated in the solicitation and contract by reference (see Block 27, SF 1449). Use this clause with its Alternate I when a time and materials or labor hour contract will be awarded. The contracting officer may tailor this clause in accordance with 12.302, except that paragraph (u) of Alternate I may be tailored only for indefinite delivery contracts and only to indicate that subcontract consent requirements apply to individual orders and not the basic contract.

* * * * *

8. Amend section 12.403 by revising paragraph (d)(1)(i) to read as follows:

12.403 Termination.

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* * * * *

PART 16—TYPES OF CONTRACTS

* * * * *

PART 44—SUBCONTRACTING POLICIES AND PROCEDURES

* * * * *

PART 52—SOLICITATION PROVISIONS AND CONTRACT CLAUSES

13. Amend section 52.212-4 by—:

a. Revising the date of the clause;

b. Adding a new fourth sentence to the introductory text of paragraph (a) of the clause; and

c. Adding Alternate I to read as follows:

52.212-4 Contract Terms and Conditions—Commercial Items.

* * * * *

CONTRACT TERMS AND CONDITIONS—COMMERCIAL ITEMS (DATE)

(a) *Inspection/Acceptance.* * * * If repair/replacement or reperformance will not correct the defects or is not possible, the Government may seek an equitable price reduction or adequate consideration for acceptance of nonconforming supplies or services.* * *

* * * * *

Alternate I (Date). When a time and materials or labor-hour contract is contemplated, substitute the following paragraphs (a), (e), (i) and (l) for those in the basic clause and add the following paragraph (u) to the basic clause.

(a) *Inspection/Acceptance.* (1) The Government has the right to inspect and test all materials furnished and services performed under this contract, to the extent practicable at all places and times, including the period of performance, and in any event before acceptance. The Government may also inspect the plant or plants of the Contractor or any subcontractor engaged in contract performance. The Government will perform inspections and tests in a manner that will not unduly delay the work and will be responsible for the costs reasonably incurred by the Contractor or its subcontractors in connection with the Government's inspection or testing activity.

(2) If the Government performs inspection or tests on the premises of the Contractor or a subcontractor, the Contractor shall furnish and shall require subcontractors to furnish all reasonable facilities and assistance for the safe and convenient performance of these duties.

(3) Unless otherwise specified in the contract, the Government will accept or reject services and materials at the place of delivery as promptly as practicable after delivery, and they will be presumed accepted 60 days after the date of delivery, unless accepted earlier.

(4) At any time during contract performance, but not later than 6 months (or such other time as may be specified in the contract) after acceptance of the services or materials last delivered under this contract, the Government may require the Contractor to replace or correct services or materials that at time of delivery failed to meet contract requirements. Except as otherwise specified in paragraph (a)(6) of this clause, the cost of replacement or correction shall be determined under paragraph (i) of this clause, but the "hourly rate" for labor hours incurred in the replacement or correction shall be reduced to exclude that portion of the rate attributable to profit. Unless otherwise specified below, the portion of the "hourly rate" attributable to profit shall be 10 percent. The Contractor shall not tender for acceptance materials and services required to be replaced or corrected without disclosing the former requirement for replacement or correction, and, when required, shall disclose the corrective action taken.

* * * * *

(e) *Definitions.* (1) The clause at FAR 52.202-1, Definitions, is incorporated herein by reference. As used in this clause—

Approved purchasing system means a Contractor's purchasing system that has been reviewed and approved in accordance with Part 44 of the Federal Acquisition Regulation (FAR).

Consent to subcontract means the Contracting Officer's written consent for the Contractor to enter into a particular subcontract.

Direct materials means those materials that enter directly into the end product, or that are used or consumed directly in connection with the furnishing of the end product or service.

Materials means—:

(1) Direct materials, including supplies ~~and services~~ transferred between divisions, subsidiaries, or affiliates of the contractor under a common control;

(2) Subcontracts for supplies ~~and services;~~

(3) Other direct costs *(e.g.,* travel, computer usage charges, etc.); or

(4) Indirect costs specifically provided for in this clause.

Subcontract means any contract, as defined in FAR Subpart 2.1, entered into by a subcontractor to furnish supplies or services for performance of the prime contract or a subcontract. It includes, but is not limited to, purchase orders, and changes and modifications to purchase orders.

Time means the labor provided by the Contractor (including any subcontracted labor) to perform the services required by the contract.

* * * * *

(i) *Payments.* (1) *Services accepted.* Payment shall be made for services accepted by the Government that have been delivered to the delivery destination(s) set forth in this contract. The Government will pay the Contractor as follows upon the submission of commercial invoices approved by the Contracting Officer:

(i) *Hourly rate.* The amounts shall be computed by multiplying the appropriate hourly rates prescribed in the contract by the Time provided under the Contract (measured by the number of direct labor hours performed~~.~~). Fractional parts of an hour shall be payable on a prorated basis. Invoices may be submitted once each month (or at more frequent intervals, if approved by the Contracting Officer) to the Contracting Officer or the Contracting Officer's representative. When requested by the Contracting Officer or the Contracting Officer's representative, the Contractor shall substantiate invoices (including any subcontractor hours reimbursed at the hourly rate in the schedule) by evidence of actual payment, individual daily job timecards, records that verify the employees meet the qualifications for the labor categories specified in the contract, or other substantiation specified in the contract. Unless the Schedule prescribes otherwise, the hourly rates in the Schedule shall not be varied by virtue of the Contractor having performed work on an overtime basis. If no overtime rates are provided in the Schedule and the Contracting Officer approves overtime work in advance, overtime rates shall be negotiated. Failure to agree upon these overtime rates shall be treated as a dispute under the

Disputes clause of this contract. If the Schedule provides rates for overtime, the premium portion of those rates will be reimbursable only to the extent the overtime is approved by the Contracting Officer.

(ii) *Materials.* (A) If the Contractor furnishes its own materials that meet the definition of a commercial item at 2.101, the price to be paid for such materials shall be the Contractor's established catalog or the market price, adjusted to reflect the—:

(1) Quantities being acquired; and

(2) Actual cost of any modifications necessary because of contract requirements.

(B) *Subcontracts.* ~~(1) Unless the subcontractor is listed in paragraph (i)(1)(ii)(B)(2) of this clause,~~ The Contractor shall be paid for the services performed by subcontractors as provided for in ~~subcontract costs will be reimbursed at actual costs as specified in~~ (u)(~~i~~)(1)(ii)(~~C~~) of this clause.

~~(2) Provided the subcontract agreement requires the contractor to substantiate the subcontract hours and employee qualification, the contractor shall be reimbursed at the hourly rates prescribed in the schedule for the following subcontractors: *[Insert subcontractor name(s) or, if no subcontracts are to be reimbursed at the hourly rates prescribed in the schedule, "None." If this is an indefinite delivery contract, the Contracting Officer may insert "Each order must list separately the subcontractor(s) for that order or, if no subcontracts under that order are to be reimbursed at the hourly rates prescribed in the schedule, insert 'None'."]*~~

(C) Except as provided for in paragraphs (i)(1)(ii)(A) and (B) of this clause, the Government will reimburse the Contractor the actual cost of materials (less any rebates, refunds, or discounts received by or accrued to the contractor) provided the Contractor:

(1) Has made payments for materials in accordance with the terms and conditions of the agreement or invoice; or

(2) Makes these payments within 30 days of the submission of the Contractor's payment request to the Government and such payment is in accordance with the terms and conditions of the agreement or invoice.

(D) To the extent able, the Contractor shall—:

(1) Obtain materials at the most advantageous prices available with due regard to securing prompt delivery of satisfactory materials; and

(2) Give credit to the Government for cash and trade discounts, rebates, scrap, commissions, and other amounts that have accrued to the benefit of the Contractor, or would have accrued except for the fault or neglect of the Contractor.

(E) *Other Costs.* Unless listed below, other direct and indirect costs will not be reimbursed.

(1) *Other Direct Costs.* The Government will reimburse the Contractor on the basis of actual cost for the following, provided such costs comply with the requirements in paragraph (i)(1)(ii)(C) of this clause: *[Insert each element of other direct costs (e.g., travel, computer usage charges, etc.) Insert "None" if no reimbursement for other direct costs will be provided.]*

(2) *Indirect Costs (Material Handling, Subcontract Administration, etc.).* The Government will reimburse the Contractor for indirect costs (i) on a pro-rata basis over the period of contract performance at the following fixed price: *[Insert a fixed amount for the indirect costs and payment schedule. Insert "$0" if no fixed price reimbursement for indirect costs will be provided.];* or (ii) in accordance with the Contractor's current cost accounting practice as disclosed to and approved by the cognizant Government auditing agency and which may be described as follows:[*insert*].

(2) *Total cost.* It is estimated that the total cost to the Government for the performance of this contract shall not exceed the ceiling price set forth in the Schedule and the Contractor agrees to use its best efforts to perform the work specified in the Schedule and all obligations under this contract within such ceiling price. If at any time the Contractor has reason to believe that the hourly rate payments and material costs that will accrue in performing this contract in the next succeeding 30 days, if added to all other payments and costs previously accrued, will exceed 85 percent of the ceiling price in the Schedule, the Contractor shall notify the Contracting Officer giving a revised estimate of the total price to the Government for performing this contract with supporting reasons and documentation. If at any time during the performance of this contract the Contractor has reason to believe that the total price to the Government for performing this contract will be substantially greater or less than the then stated ceiling price, the Contractor shall so notify the Contracting Officer, giving a revised estimate of the total price for performing this contract, with supporting reasons and documentation. If at any time during performing this contract, the Government has reason to believe that the work to be required in performing this contract will be substantially greater or less than the stated ceiling price, the Contracting Officer will so advise the Contractor, giving the then revised estimate of the total amount of effort to be required under the contract.

(3) *Ceiling price.* The Government will not be obligated to pay the Contractor any amount in excess of the ceiling price in the Schedule, and the Contractor shall not be obligated to continue performance if to do so would exceed the ceiling price set forth in the Schedule, unless and until the Contracting Officer notifies the Contractor in writing that the ceiling price has been increased and specifies in the notice a revised ceiling that shall constitute the ceiling price for performance under this contract. When and to the extent that the ceiling price set forth in the Schedule has been increased, any hours expended and material costs incurred by the Contractor in excess of the ceiling price before the increase shall be allowable to the same extent as if the hours expended and material costs had been incurred after the increase in the ceiling price.

(4) *Access to records.* At any time before final payment under this contract, the Contracting Officer (or authorized representative) will have access to the following (access shall be limited to the listing below unless otherwise agreed to by the Contractor and the Contracting Officer):

(i) Records that verify the employees whose time has been included in any invoice meet the qualifications for the labor categories specified in the contract;

(ii) For labor hours (including any subcontractor hours reimbursed at the hourly rate in the schedule), when ~~timecards are required as~~ substantiation for payment is required—:

(A) ~~The original timecards~~Contractor records that reasonably support the amount of Time charged to the contract;

(B) The Contractor's timekeeping procedures; and

(C) Contractor records that show the distribution of labor between jobs or contracts.~~; and~~

~~(D) Employees whose time has been included in any invoice for the purpose of verifying that these employees have worked the hours shown on the invoices.~~

(iii) For material and subcontract costs that are reimbursed on the basis of actual cost—:

(A) Any invoices or subcontract agreements substantiating material costs; and

(B) Any documents supporting payment of those invoices.

(5) *Overpayments/Underpayments.* (

* * * * *

(l) *Termination for the Government's convenience*

* * * * *

(u) *Subcontracts.* Unless the Contract specifically provides otherwise, the Contractor is permitted to use Subcontractor personnel and charge for the services performed by such personnel at the Contract labor rates provided that such subcontractor personnel satisfy the qualification and other requirements for the labor categories for which the Contractor seeks compensation.~~(1) If the Contractor has an approved purchasing system, the Contractor shall obtain the Contracting Officer's written consent only before placing subcontracts identified in an addendum to this clause.~~

(2) If the Contractor does not have an approved purchasing system, consent to subcontract is required for any subcontract that—:

(i) Is of the cost-reimbursement, time-and-materials, or labor-hour type; or

(ii) Is fixed-price and exceeds—:

(A) For a contract awarded by the Department of Defense, the Coast Guard, or the National Aeronautics and Space Administration, the greater of the simplified acquisition threshold or 5 percent of the total estimated cost of the contract; or

(B) For a contract awarded by a civilian agency other than the Coast Guard and the National Aeronautics and Space Administration, either the simplified acquisition threshold or 5 percent of the total estimated cost of the contract.

(iii) Exceptions to this requirement may be as specified by the Contracting Officer in an addendum to this clause.

(3) The Contractor shall notify the Contracting Officer reasonably in advance of placing any subcontract or modification thereof for which consent is required under paragraph (u)(1) or (u)(2) of this clause, including the following information:

(i) A description of the supplies or services to be subcontracted.

(ii) Identification of the type of subcontract to be used.

(iii) Identification of the proposed subcontractor.

(iv) Extent of competition or basis for determining price reasonableness.

(v) The proposed subcontract amount.

(vi) If a time-and-materials or labor-hour subcontract, a list of the labor categories, corresponding labor rates and estimated hours.

(4) The Contractor is not required to notify the Contracting Officer in advance of entering into any subcontract for which consent is not required under paragraph (u)(1) or (u)(2) of this clause.

(5) Unless the consent or approval specifically provides otherwise, neither consent by the Contracting Officer to any subcontract nor approval of the Contractor's purchasing system shall constitute a determination—:

(i) Of the acceptability of any subcontract terms or conditions; or

(ii) Relieve the Contractor of any responsibility for performing this contract.

~~(6) No subcontract or modification thereof placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis, and any fee payable under cost-reimbursement type subcontracts shall not exceed the fee limitations in FAR 15.404-4(c)(4)(i).~~

~~(7) The Contractor shall give the Contracting Officer immediate written notice of any action or suit filed and prompt notice of any claim made against the Contractor by any subcontractor or vendor that, in the opinion of the Contractor, may result in litigation related in any way to this contract, with respect to which the Contractor may be entitled to reimbursement from the Government.~~

~~(8) If the contractor enters into any subcontract that requires consent without obtaining such consent, the Government will not be liable for any costs incurred under that subcontract prior to the date the contractor obtains the required consent. Any payment of subcontract costs incurred prior to the date of the consent will be reimbursed only if the Contracting Officer subsequently provides the consent required by paragraph (u) of this clause.~~

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To farcase.2003-027@gsa.gov, farcase.2004-015@gsa.gov
cc
bcc
Subject FAR Cases 2003-027 & 2004-015

December 9, 2005

General Services Administration

Regulatory Secretariat (VIR)

1800 F Street, NW, Room 4035

ATTN: Ms. Laurieann Duarte

Washington, D.C. 20405

Via email: farcase.2003-027@gsa.gov

farcase.2004-015@gsa.gov

Subject: FAR Case 2003-027

FAR Case 2004-015

Dear Ms. Duarte:

The Project On Government Oversight ("POGO") provides the following public comment to FAR Case 2003-027 (Federal Acquisition Regulation; Additional Contract Types – 70 Fed. Reg. 56318, Sept. 26, 2005) and FAR Case 2004-015 (Federal Acquisition Regulation: Payments Under Time-and-Materials and Labor-Hour Contracts – 70 Fed. Reg. 56314, Sept. 26, 2005). POGO investigates, exposes, and seeks to remedy systemic abuses of power, mismanagement, and subservience by the federal government to powerful special interests. POGO is not opposed to time-and-material ("T&M") and labor-hour ("LH") contracts *per se* , but it opposes the

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proposed rules because FAR Case 2003-027 does not subject commercial contracts to full oversight and audit provisions which protect taxpayer interests. Additionally, FAR Case 2004-015 does not limit costs billed to the government on "non-commercial item contracts."

Additional Contract Types (FAR Case 2003-027)

The proposed rule will implement section 1432 of the National Defense Authorization Act for Fiscal Year 2004 (Public Law 108-136) in the Federal Acquisition Regulation ("FAR"). Section 1432 amends section 8002(d) of the Federal Acquisition Streamlining Act (FASA) to expressly authorize the use of T&M/LH contracts for the procurement of commercial services that are commonly sold to the general public and are purchased on a competitive basis. Although the proposed rule includes a provision for determinations and findings containing sufficient facts and rationale to justify why fixed-firm pricing arrangements are not suitable, other taxpayer protections are missing.

T&M/LH contracts have been used in both the private sector and government markets. The proposed rule, however, has less to do with commercial practices than it does with putting American taxpayer dollars at risk. For example, two industry witnesses testified before the Acquisition Advisory Panel (the "AAP" was authorized by Section 1423 of the Services Acquisition Reform Act of 2003) that they do not prefer to use T&M contracts and would not use them for information technology work. Both industry witnesses stated that fixed-price contracts are the more preferred contracting vehicle. In essence, Congress and federal agencies were duped into believing that TM & LH contracts were standard commercial practice.

POGO testified before the AAP stating that TM and LH contracts allow contractors to bill the government without producing a product or service and that the lack of oversight requires those contracts to be used in limited circumstances only. POGO is not the only entity concerned with the use of such contracts. The Defense and General Service Administration Inspectors General and the Government Accountability Office have all expressed concerns with the risks placed on the government and unjustified use of TM & LH contracts. The Senate must have looked into the crystal ball when it considered TM & LH contracts, because it had included, but later withdrew an amendment that placed strict safeguards and limitations on TM & LH contracts.

The main difference between the commercial market and the proposed rule is the rule's contractor-friendly threshold governed by FAR 52.212-4, stating that a contractor "agrees to use its **best efforts** to perform the work specified in the Schedule and all obligations under this

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contract within such ceiling price." (Emphasis added) These types of contracts pay for time or money spent, not for milestones reached or work completed. There is no consumer in the commercial market that would blindly allow a car repair shop to work on his or her car for up to $1,000 without any guarantee that the car will be fixed.

FAR 52.232-7(e) prescribes that "[a]t any time before final payment under this [T&M/LH] contract the Contracting Officer may request audit of the invoices or vouchers and substantiating material." That provision, however, contradicts other provisions for commercial items that are not subject to post-award audits.

For T&M/LH contracts to provide benefits to the government and protect taxpayer interests, they must be subject to full oversight, audits, and Cost Accounting Standards protections. POGO opines that post-award audits must be included in T&M/LH contracts. In most instances, audits could be conducted when the contractor notifies the government that the contract cost will exceed 85% of the ceiling. Additionally, POGO avers that the contract must include refund or price reduction clauses that will allow the government to recoup any overages identified in the audit.

The government already has the ability to use T&M and LH contracts, but POGO's concern is with the use of such contracts under FAR Part 12, which does not provide adequate taxpayer protections.

Payments Under Time-and-Materials and Labor-Hour Contracts (FAR 2004-015)

Because of confusion concerning subcontract costs for good and services, acquisition professionals and contractors have raised the question of whether a prime contractor is entitled to be paid for a subcontractor's work based on the prime's hourly rate, which costs the government hundreds of millions of dollars each year, or be paid the rate the prime paid to the subcontractor. In other words, does the FAR allow the government to pay for subcontract hours at the negotiated prime contractor rates rather than at subcontract prices.

As I read it, the proposed rule will allow a prime to bill the government at its high rate(s) (rather than the subcontractor's actual rate(s)) so long as the prime specifies that arrangement in the contract. In essence, the government will allow over billing so long as it is on notice.

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The *Washington Post* has reported that $20-an-hour subcontract workers were billed by the prime contractors to the government at $48 per hour. Contractor representatives claim that those increased hourly rates include "risk and overhead." That assertion is erroneous because the prime contractors can already add overhead, general and administrative expenses, and profit to their subcontract costs. The primes are misrepresenting their subcontract costs by submitting bills to the government claiming that the rates they are paying subcontractors are the same as their own prime contract rates. In fact, what the primes are doing is shopping their hourly rate(s) to the lowest cost, and possibly the least qualified, subcontractor they can find. Then, for each hour the subcontractor works, the prime contractor bills its own labor rate, not the subcontractor' s actual billed costs to the prime. As a result, the prime recovers profit on the subcontract costs, which could result in a windfall profit.

POGO opposes the proposed regulation. The federal government should not enter into T&M/LH contracts that allow prime contractors to bill the agency for subcontracted or purchased labor or material at an amount in excess of the prime contractor's actual costs for acquiring the subcontracted or purchased labor or material. The industry's over billing of the government is nothing more that an attempt at increasing prime contractors' profit margins. The problem is that the government is not getting what it contracted for; instead, the government is paying high labor rates to have a middleman. The fact that some agencies are willing to accept higher hourly rates strongly suggests that something is wrong with the government's buying system.

Sincerely,

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2003-027-11

Contract Services Association
Excellence in Government Contracting

December 9, 2005

Ms. Laurieann Duarte
General Services Administration
Regulatory Secretariat (VR)
1800 F Street, N.W.
Room 1035
Washington, D.C. 20405

Re: FAR Case 2003-027, Additional Contract Types

Dear Ms. Duarte:

On behalf of the members of the Contract Services Association (CSA), I appreciate this opportunity to submit comments on the Proposed Rule regarding Additional Contract Types published in the Federal Register on September 26, 2005 (70 Fed. Reg. 56318). This Proposed Rule is intended to implement Section 1432 of the National Defense Authorization Act of 2004. Title XIV, referred to as the Services Acquisition Reform Act of 2003, amended Section 8002(d) of the Federal Acquisition Streamlining Act of 1994 (FASA) to expressly authorize the use of time-and-materials (T&M) and labor-hour (LH) contracts for certain categories of commercial services under specified conditions.

By way of background, CSA is the nation's oldest and largest association of service contractors representing over 200 companies that provide a wide array of services to Federal, state, and local governments. CSA members perform over $40 billion in Government contracts and employ nearly 500,000 workers, with nearly two-thirds of CSA companies using private sector union labor. CSA members represent the diversity of the Government services industry and include small businesses, 8(a)-certified companies, small disadvantaged businesses, women-owned, HubZone, Native American owned firms and global multi-billion dollar corporations. CSA promotes Excellence in Contracting by offering significant professional development opportunities for Government contractors and Government employees, including the only program manager certification program for service contractors.

In general, CSA cannot support the proposed rule as currently written. We support the comments submitted by the Council of Defense and Space Industry Associations (CODSIA) and the Information Technology Association of America. The CSA comments are intended to highlight certain key areas of critical concern to CSA members.

Introduction

Use of T&M/LH contracting method in commercial business activities by the private sector permits effective cost control, and provides operational flexibility, especially in a dynamic business environment. Companies are able to use market rates to attract key talent, and still control project costs with dollar ceilings. In addition, T&M/LH contracting reduces redundancies and inefficiencies through flexibility in administration, and it allows rapid response

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to business needs by allowing changes in staffing levels without delay. With proper use, the Government can reap the same benefits when using T&M/LH contracts.

CSA strongly supported the enactment of Section 1432 of the 2003 Services Acquisition Reform Act (SARA). Previously, Section 8001 of the 1994 Federal Acquisition Streamlining Act (FASA), services were considered commercial items based on established catalog prices for specific tasks under standard terms and conditions. The absence of an explicit prohibition on the use of T&M/LH contracting, however, left the issue of their use an open question. SARA addressed this confusion, explicitly authorizing T&M contracting under specific circumstances. Section 1432 is very straightforward in its language and intent. Essentially, this section authorized the use of T&M/LH contracts subject to three conditions: (1) the contracting officer executes a Determination & Finding that no other contract type is suitable; (2) a ceiling price be included in the contract that the contractor exceeds at its own risk; and (3) any subsequent change in the ceiling price be made only after a written determination that changing the ceiling price was in the best interests of the procuring agency. Another feature of Section 1432 is that any commercial services purchased under the new authority be of the type commonly sold to the general public through use of T&M/LH contracts.

On September 20, 2004, the Councils published an Advanced Notice of Proposed Rulemaking; on November 23, CSA submitted comments on the ANPR, noting, among other things, that Time and Material (T&M) contracting allows for a rapid response and is administratively simple for both the buyer and the seller. However, CSA also raised several concerns with the proposal outlined in the ANPR.

General Comments

As with the ANPR, CSA continues to be concerned that the proposed rule contradicts – and goes beyond – the intent of SARA by potentially creating, in practice and effect, a prohibition on the use of T&M contracts. Specifically, the proposed rule, as it impacts *commercial* services, would add administrative burden and procedural complication to the utilization of T&M contracts, which would inhibit the use of these contracts as a practical contracting tool. For example, the proposed requirement to process a D&F for each T&M task order is beyond the intent of Section 1432 and appears to show little confidence in the business judgment of contracting officers.

The proposed rule adds to the statutory requirements further mandatory elements necessary to use this contracting type – requirements that could restrain what would be a legitimate use of T&M/LH contracting in the context of commercial item procurements. We also note that nowhere in this proposed regulation is there any further, or refined, guidance related to the Government's responsibility to engage in proper surveillance of the contractor of which the proposed regulations appears to be so concerned.

Direct Materials

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For example, direct materials are defined as including "supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control." Under the proposed rule, labor which is used from a commercial division to support a procurement would only be allowed to be billed at "cost" without profit. This unexplained restriction on the use of interdivisional labor would require that the cost of the individual be identified and exposed, subjecting its "allowability" to a determination under FAR 31.205-26(e). CSA perceives no reason to require the application of cost principles to commercial services contracts. Contractors should have the ability to use any of their own resources in order to perform with work as best possible and not face the penalty of profit erosion. Again, these contracts have commercial market reference points; therefore, disallowing profit discourages the vendor from using its best employees to meet the Government's needs.

Subcontracts

The proposed rule appears somewhat complex and confusing with regard to the use of, and payment for, a subcontractor's labor. The language set forth in the Alternate subparagraphs implies that only those subcontractors for whom the contracting officer has given consent are to be reimbursed at the hourly rates provided for in the prime contract.

As noted above, the thrust of acquisition reform has been to utilize commercial practices where appropriate. In this regard, CSA believes the restrictions imposed on vendor subcontractor determinations are inconsistent with the underlying intent of commercial acquisition

Withholds and Rebates

In regards to funds withholding, CSA members are concerned that commercial vendors may not be accustomed to the notion that the Government might withhold funds from payment. There is concern that with the use of T&M/LH contracting in the commercial context, contracting officers may elect to withhold even though the practice is not specifically allowed by the appropriate payment clause. To avoid any confusion here, explicit language should be set out that bars such withholdings.

There also is concern that the proposed regulation requires vendors to provide the Government credit for rebates on commercial T&M services. Such a requirement presents some complications. Vendors typically provide some services (*e.g.,* maintenance on standard equipment) through the organizational resources of their commercial business. Federal divisions have little visibility into those business units, creating a dilemma as to how to account for a rebate. For this reason, CSA believes this requirement should be deleted from the proposed rule.

Access to Employees

Finally, CSA is concerned that the proposed rule would give contracting officers the right, on commercial T&M/LH contracts to interview contractor employees to verify whether the

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Contract Services Association
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employee performed the work indicated on the invoice. While, contractors should support billings submitted to the Government for payment, the proposed rule significantly exceeds customary commercial practice – and in exceeds the requirements of the existing payment provisions.

Conclusion

Again, CSA appreciates this comment on the proposed rule, and we echo CODSIA's request that further public meetings be held to discuss this important proposed rule and the related non-commercial item proposed rule. Indeed, we would suggest that any issuance of a final rule be delayed until the Acquisition Advisory Panel has released its report and recommendations since there may be a conflict between their recommendations and this proposed rule as it relates to commercial items. Furthermore, we are concerned over any implementation since the Cost Accounting Board has yet to issue appropriate waivers related to commercial services.

Sincerely,

Chris Jahn

Chris Jahn
President

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November 21, 2005

General Services Administration
Regulatory Secretariat (VIR)
1800 F Street, N.W.
Room 4035
ATTN: Laurieann Duarte
Washington, DC 20405

Re: FAR Case 2004-015, Payment Under Time-and-Materials and Labor-Hour Contracts, 70 Fed. Reg. 56314 (September 26, 2005); FAR Case 2003-027, Additional Contract Types, 70 Fed. Reg. 56318 (September 26, 2005)

Dear Ms. Duarte:

The Coalition for Government Procurement (Coalition) is pleased to submit the attached comments on FAR Cases 2003-027 and 2004-015 concerning Time and Materials and Labor Hours (T&M-LH) Contracting. The Coalition is a non-profit association representing over 330 companies selling commercial services and products to the federal government. Our members are comprised of large and small firms that sell through FSS Multiple Award Schedule (MAS) contracts as well as other Indefinite Delivery Indefinite Quantity (IDIQ) and Government Wide Acquisition Contracts (GWAC's). Coalition members account for over 70% of schedule sales and a significant amount of GSA GWAC transactions. Since 1979, our mission has been to work with decision makers in GSA, the executive branch generally, and Congress to bring about common sense acquisition policies in the federal market place.

Coalition members experience a significant use of T&M-LH contracting in their commercial business activities. This contracting method permits effective cost control and provides operational flexibility, especially in a dynamic business environment. Companies are able to use market rates to attract key talent and still control project costs with dollar ceilings. In addition, T&M-LH contracting reduces redundancies and inefficiencies through flexibility in administration, and it allows rapid response to business needs by allowing changes in staffing levels without delay. If these benefits can be experienced in the private sector, the Coalition believes, especially in this time of budget constraint and the need for programmatic efficiency, these benefits should be brought to those who serve the public, as well. For this reason, we appreciate the opportunity to assist the government finding an appropriate methodology for the implementation of T&M-LH contracting.

Discussion

Section 1432 of the Services Acquisition Reform Act (SARA) of 2004 amended Section 8002 of the Federal Acquisition Streamlining Act (FASA) to authorize T&M-LH contracting for commercial services. Up until that time, there was confusion regarding the use of this contracting method. Under Section 8001 of FASA, services were considered commercial items based on established catalog prices for specific tasks under standard terms and

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conditions. In addition, the Act stated that firm fixed price and fixed price with economic price adjustment should be used to the maximum extent practicable for commercial item acquisition and that cost-type contracts were not to be used.[1] The absence of an explicit prohibition on the use of T&M contracting, however, left the issue of their use an open question. SARA addressed this confusion, explicitly authorizing T&M contracting under specific circumstances.[2]

Generally, Coalition members are concerned that the proposed rules would contradict the intent of SARA by creating, in practice and effect, a prohibition on the use of T&M-LH contracts. Specifically, the proposed rules, notably the rule for commercial services, appear to add administrative burden and procedural complication to the utilization of T&M-LH contracts so as to inhibit the use of these contracts as a practical contracting tool.

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Significant D&F Requirement

Currently, FAR 12.207, 16.601, and 16.602 collectively mirror the thrust of the grant of T&M-LH authority set forth in SARA. The proposed rule, however, adds to these regulatory requirements further mandatory elements of a D&F necessary to use this contracting type. These mandatory elements can effectively restrain what would be a legitimate use of T&M-LH contracting in the context of commercial item procurements. For instance, in the case of an IDIQ contract that contemplates award of only T&M-LH orders, the D&F must be approved one level above the contracting officer. This approval requirement, however, exceeds that of the non-commercial use of T&M ordering procedures under indefinite delivery contracts, a situation where, presumably, the government is exposed to greater risk than in the commercial context given the absence of a commercial market reference that might serve as a barometer for the services being procured. Assuming that there is a desire to use T&M-LH contracts to further the government's best interest, the absence of a rationale that would demonstrate how the government's risk increase in this commercial context compels the elimination of this extra approval requirement.

Restrictive Reimbursement for "Materials"

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[1] Section 8002(d) of Title VIII of PL 103-355 specifically provides as follows:

(d) USE OF FIRM, FIXED PRICE CONTRACTS- The Federal Acquisition Regulation shall include, for acquisitions of commercial items--

(1) a requirement that firm, fixed price contracts or fixed price with economic price adjustment contracts be used to the maximum extent practicable; and

(2) a prohibition on use of cost type contracts.

[2] As set forth under Section 1432, for purchases made on a competitive basis; where the services fall within specific categories (including those specified by the Administrator of OFPP); where the CO executes a D&F that no other contract type is suitable; and where the CO includes a ceiling price that the contractor carries all risk for exceed and which may be changed only by written determination placed in the contract file that such change is in the agency's best interest.

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Direct materials are defined as including "supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control." Under the rule, labor which is used from a commercial division to support a Part 12 procurement would only be allowed to be billed at "cost" without profit and/or fee, unless a vendor's practices, and the materials, meet the criteria of 52.212-4 (Alt. I), subsection (i)(1)(ii). This use of interdivisional labor would require that the "cost"[3] of the individual be identified and exposed, potentially subjecting its "allowability" to a determination under Cost Principles.

Several Coalition members have commented that, as commercial companies, they simply do not have the systems necessary to meet an onerous, government-only requirement, nor is it cost effective for them to implement such systems for a small part of their overall business. Doing so would also be counter to every major piece of procurement reform legislation that, at their core, envision government buyers purchasing more like their commercial counterparts and the cessation of government-unique requirements for commercial items. We strongly recommend that commercial acquisitions be clearly separated from government-only requirements, especially those as onerous as cost accounting standards.

In a commercial context, members believe that vendors under these contracts should have the ability to use any of their own resources without penalty of profit erosion. Again, these contracts have commercial market reference points for testing price reasonableness competitively, and thus, to disallow profit (or fee) discourages the vendor from using its best employees to meet the government's needs where appropriate.[4] Moreover, allowing this fee is consistent with the notion expressed at the public meeting that the government should pay for actual contract performance. Compelling vendors to seek non-company employees may not always be the cost-effect, best value alternative available, but allow vendors to be paid for based on form over substance. Finally, although consideration should be given to the notion that utilization of these services through an in-house channel includes a process that does not exist when these services are provided elsewhere[5], and thus, justifies the inclusion of that attendant fee.

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[3] The use of the word "cost" has a defined meaning as a term of art in a government contracting context, and it is typically associated with Cost Accounting Standards (CAS). From an accounting standpoint, vendors that commonly operate in a commercial environment are not structured along the lines of CAS principles. The notion of cost may have a different meaning in their commercial practice context, producing complications for the federal divisions of those companies that rely on commercial organizations to deliver many offerings. A potential solution for this conflict may be to redefine the notion of cost in the commercial context to omit expressly the application of CAS definitions and rules.

[4] Interestingly, although subcontractors may be listed in the proposal/contract, and therefore, be billed at the contract labor rate, there appears to be no provision made for identifying other divisions of the vendor in the original proposal/contract, such that they could be billed at the contract labor hour rate(s). Perhaps the addition of such a provision might provide a step toward compromise on this point. That such a solution is only a step should be made clear. There are circumstances where suppliers simply cannot be added at the time an offer is submitted simply because commercial vendors may work with multiple suppliers in multiple contexts. Thus, provision needs to be made for the quick addition of those suppliers to the contract, as well. Moreover, the government may want to consider defining a commercial payment timeframe to assure that payment practices in the commercial market align with those of the government market.

[5] Though certainly not of a consequence to invoke CAS-like accounting.

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Potentially Restrictive Use of Subcontractors

The proposed rule appears somewhat complex and confusing with regard to the use of and payment for a subcontractor's labor. For instance, the proposed language for FAR 52.212-4 Alternative 1 introduces into the commercial item contracting environment the contractor purchasing system review (CPSR) process that appears to be more suitable for non-commercial item acquisitions. In addition, the language of the alternative implies that only those subcontractors for whom the contracting officer has given consent are to be reimbursed at the hourly rates provided for in the prime contract.

As noted above, the thrust of acquisition reform has been to utilize commercial practices where appropriate. In this regard, members believe the restrictions imposed on vendor subcontractor determinations are inconsistent with the underlying intent of commercial acquisition. Commercial contractors may not perform sufficient government business to justify the establishment of a CPSR for one component of their government commercial business, so the government may lose out on the number of available competitors in this contracting context. Again, until the value-add of such a system in a commercial context is made apparent, the requirement should not be imposed.

Concerns Regarding Withholding

Some members expressed concern that commercial vendors may not be accustomed to the notion that the government might withhold funds from payment as it does in the non-commercial context. There is concern that with the use of T&M-LH contracting in the commercial context, contracting offices may elect to proceed with requiring withholdings even though the practice is not specifically allowed by the appropriate payment clause. To avoid any confusion here, explicit language should be set out that bars such withholdings.

Equity in Rebates

There is concern among our members that the proposed regulation requires vendors to provide the government credit for rebates on commercial T&M services. Such a requirement presents some complications. Vendors typically provide some services (*e.g.,* maintenance on standard equipment) through the organizational resources of their commercial business. Federal divisions have little visibility into those business units, creating a dilemma as to how to account for a rebate. For this reason, members believe that the government should delete this requirement.

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Reimbursement for Materials

The updated definition of Direct materials in 16.601(a)(1) and 52.232-7(b)(2)(i) includes "supplies and services transferred between divisions, subsidiaries, or affiliates of the contractor under a common control." The concerns with this language of the proposed rule

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are substantially similar to those express above for FAR 2003-027 (see above). Though clearly the government has an interest in assuring that it is not subject to over-reaching in this context, the implication of "cost" principles represents a potential over reaction and should be avoided.

The Coalition recommends that the proposed rule for commercial Time and Material, Labor Hour contracts be withdrawn and substantially revised to better reflect the intent of Congress. This intent was to preserve Time and Material contracting for the procurement of commercial services when it is in the government's best interest to use this method. We believe that Time and Material, Labor Hour contracts continue to be a valuable government contracting tool that, properly utilized, can play a major role in meeting the contracting needs of a diverse government market.

We appreciate the opportunity to provide comments on these proposed rules, and we stand ready to assist you in your efforts to provide effective implementation guidance to agencies and vendors for T&M-LH contracting.

Sincerely,

Edward L. Allen
Executive Vice President
Coalition for Government Procurement

U.S. General Services Administration
Office of Inspector General

2003-027-13

December 12, 2005

General Services Administration
Regulatory Secretariat (VR)
1800 F Street, NW
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Washington, D.C. 20405
Attn: Laurie Duarte

Re: Comments on FAR Case 2003-027, Proposed Rule Regarding Additional Commercial Contract Types

Dear Ms. Duarte:

This transmits the comments of the General Services Administration, Office of Inspector General (GSA OIG) on the above-captioned proposed rule. The rule, which would implement Section 1432 of the Services Acquisition Reform Act (SARA), authorizes the use of time & materials and labor-hours (T&M/LH) contracts for the acquisition of commercial services. We note that the FAR Council made changes to the provisions of the Advance Notice of Proposed Rulemaking (ANPR) -- notably in the areas of strengthening the access to records provisions -- that addressed many of the concerns we expressed in our initial comments dated November 19, 2004. Similarly, we appreciate the clarifications made to the ANPR in the area of limiting the SARA-provided authority to competitive procurements. Our main comments on the proposed rule have to do with our continued concerns regarding reimbursement for subcontract costs, and providing guidance on categories of commercial services subject to this authority. We would also advocate that the proposed rule be revised to clarify how certain provisions would apply to indefinite delivery indefinite quantity contracts (IDIQs), including Multiple Award Schedules (MAS) contracts.

Subcontracting Reimbursement Provisions Should Be Limited to Actual Costs Paid By the Contractor

The proposed rule currently allows for subcontractor effort to be reimbursed at the prime's labor rates under certain circumstances -- namely pursuant to the CO's specific permission and if the prime substantiates in some fashion the subcontractor's hours and employee qualifications. Our Office's position continues to be that it is in the Government's best interest to only allow reimbursement for subcontractor effort at actual costs (as long as those costs do not exceed the prime's rates). Our audit work has indicated that in many instances, a significant -- and in our view unreasonable -- differential exists (nearly double in one case) between subcontractor employee rates and those of the prime vendor. We have also received correspondence from subcontractors

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reporting the charging for their time on contracts at the prime contractor's rates; the subcontractor's rate was $78 and the prime was charging its own rate of $104. The proposed rule would allow reimbursement at the prime's rate if the "subcontract agreement requires the contractor to substantiate the subcontract hours and employee qualification." We question whether in practice COs have the expertise or time to assess the existence or quality of a contractor's mechanism to oversee the qualifications and hours worked by subcontractor employees. In our view, the only way to substantiate qualifications and hours worked is through examination of payrolls and resumes for each subcontractor so engaged. At a minimum, the proposed rule should be revised to provide COs with specific guidance regarding what oversight efforts by a prime contractor would be adequate in this regard.

Given the risks inherent in T&M/LH contracting overall, and the prevalence of this contracting vehicle government-wide for services procurements, we believe the rule should provide reimbursement of subcontractor effort only at actual costs paid. We agree that vendors should make a reasonable profit on services provided to the Government; however, we do not see any justification for unduly enriching prime contractors by allowing them to charge their own higher rates for subcontractor effort. Moreover, permitting T&M/LH contractors to bill their established rates for work they subcontract will likely have the unintended consequence of the creation of new vendor organizations developed solely to extract higher profits from Government projects. Finally, we must also point out that those providers who believe the Government would be best served by permitting the wide use of subcontracts are free to do so in the context of fixed price agreements.

More Guidance Should Be Provided On Categories of Commercial Services Subject To Authority

T&M/LH contracts or orders present unique concerns regarding cost-risk and cost containment to the Government. For this reason, we believe it is advisable to -- while reasonably implementing the SARA authorizing statute -- limit as much as possible the types of services eligible to be procured. In this connection, we commented in response to the ANPR that OFPP should formulate a list of types of services that are commonly procured commercially using T&M/LH vehicles; we noted that such a list would help individual COs with their market research. The proposed rule would not include a list, and instead would require individual COs in each instance to perform market research to justify the use of a T&M/LH contract. We continue to believe that a list of types of services commonly sold commercially using T&M/LH vehicles would be beneficial to COs as a starting point in choosing contract type, and in COs' drafting of the required determination and findings document for use of a T&M/LH vehicle.

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General Clarification Needed; Reimbursement Determinations in the Context of IDIQ Contracts Should Be Clarified

We believe several aspects of the rule need clarifying. First, the proposed rule's provisions regarding reimbursement for subcontractor effort are difficult to follow. We would suggest that the provisions -- at proposed section 52.212-4(i)(1)(ii)(B) -- be revised or restated in a clearer fashion. We also note that the proposed rule uses the term "schedule" repeatedly. The use of this term may be confusing to some who understand it to refer to MAS or federal supply schedules contracts. For example, the subcontract reimbursement provision at section (i)(1)(ii) includes italicized language that refers to "hourly rates prescribed in the schedule for the following subcontracts." This could be read to suggest that, in the context of a MAS contract, separate rates for subcontractors exist. We would suggest that any final rule clarify, perhaps in the preamble, that the term is not meant to connote MAS contracts in the context of this rule.

Further, the rule's provisions regarding allowability of other direct costs or indirect costs (fixed amounts), and the reimbursement method for subcontractor effort, need to be clarified in the context of IDIQ or MAS contracts. Specifically, we do not believe the proposed rule's coverage adequately explains which contracting officer -- the CO who awards the contract or the one who awards the task order -- has the authority or ability to make these reimbursement determinations.

Other Concerns

The provisions of the rule relating to allowing other direct costs and indirect amounts should be revised to make clear that such items will only be allowed if they are not already being recovered through the labor rate. Specifically, we would recommend that language be added to the payments sections (i)(1)(ii)(E)(1) & (2) to convey that such amounts or items are allowable only if they "are not already included in the loaded labor rates." We would also ask that consideration be given to expanding somewhat the access to records provision of the proposed rule at section (i)(4). The provision states, "access shall be limited to the listing below unless otherwise agreed to by the Contractor and the Contracting Officer." We believe the Government should not limit itself expressly to only the documents specifically listed, and we would advocate eliminating this language. Finally, the proposed rule's coverage regarding consent to subcontract at 52.212-4(u) allows COs to retroactively grant their consent for subcontracts, thus allowing reimbursement of work. Specifically, the language at proposed section (u)(8) provides that "Any payment of subcontract costs incurred prior to the date of the consent will be reimbursed only if the Contracting Officer subsequently provides the consent required . . ." We would advocate that this provision be eliminated and that the Government reimburse for subcontractor effort requiring consent only if proper advance consent is in fact obtained.

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Please feel free to call Eugene Waszily, Assistant Inspector General for Auditing on (202) 501- 0374 or Virginia Grebasch, Acting Counsel to the Inspector General, on (202) 501-1932 regarding these comments.

Sincerely,

Brian D. Miller
Inspector General